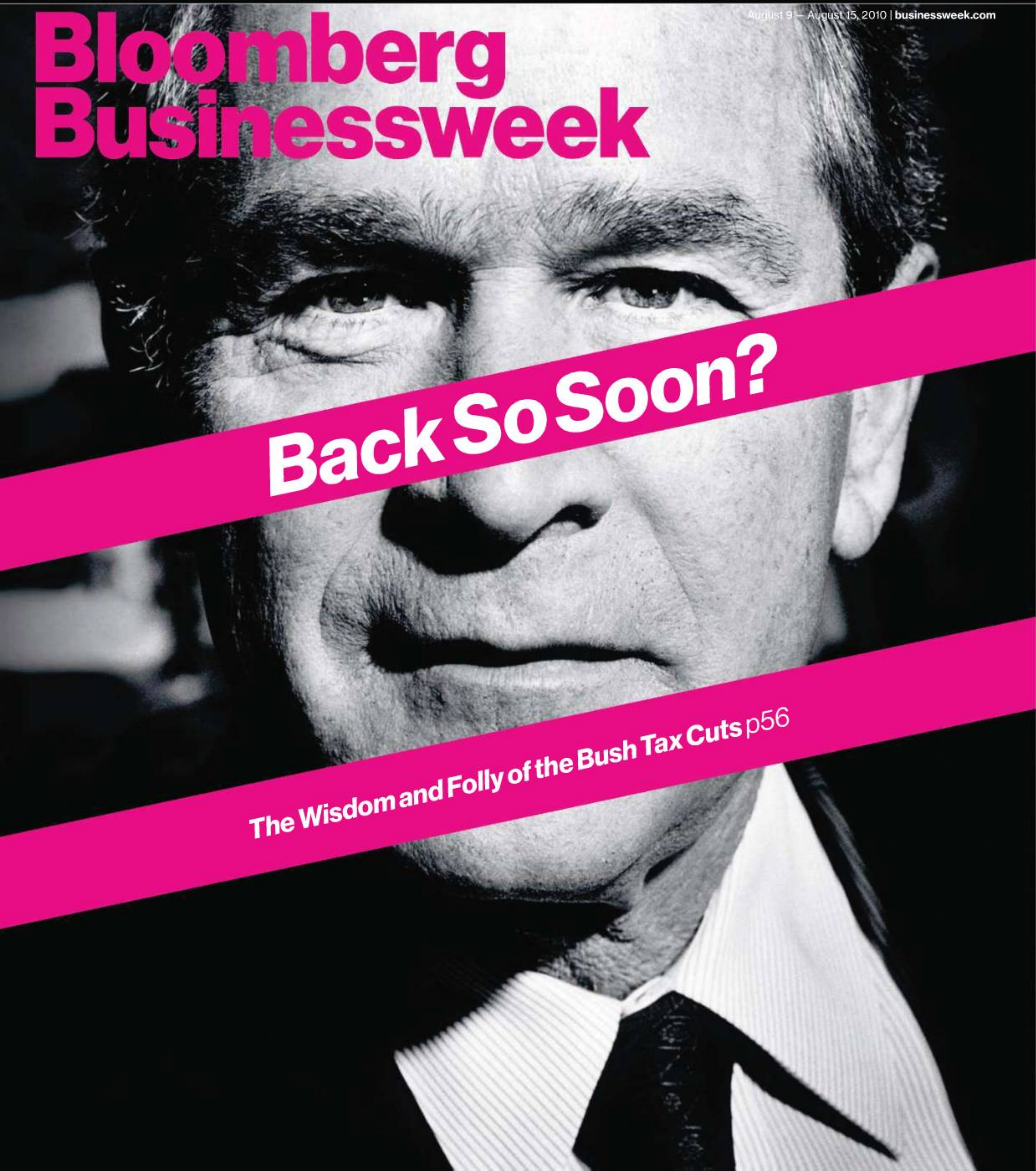
Technology
The Man Who Might, Possibly, Could Own Facebook
p35

Companies
HOW HARRAH'S WINS IN VEGAS
p70

Etc.
Executives Without Cell Phones
p77

Plus

American Apparel Teeters	p62
Obama, Venture Capitalist	p28
The Politics of Fining BP	p26
Kenmore's Talking Washer	p23
Focus On: Jobs	p51



August 9 — August 15, 2010 | businessweek.com

Bloomberg Businessweek

Back So Soon?

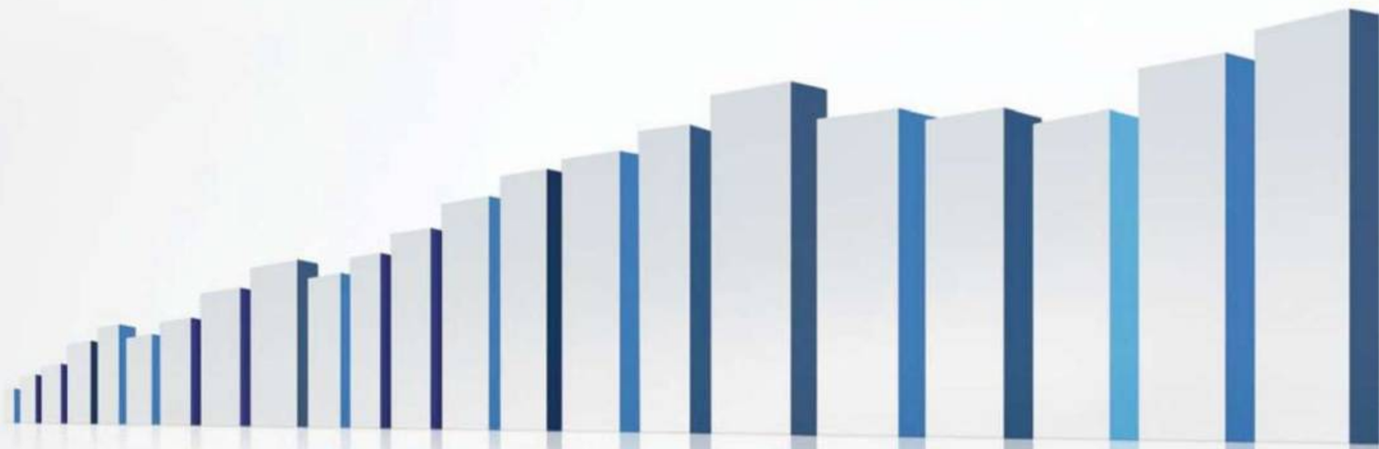
The Wisdom and Folly of the Bush Tax Cuts p56

We hold our value to a higher standard.

Ford Fusion is rising to the top. It's now projected to hold its resale value better than Camry.* It also has better quality than Accord.** And better fuel economy than both of them.† The facts are in, and things are looking up for Fusion.

THE FORD **FUSION**

fordvehicles.com



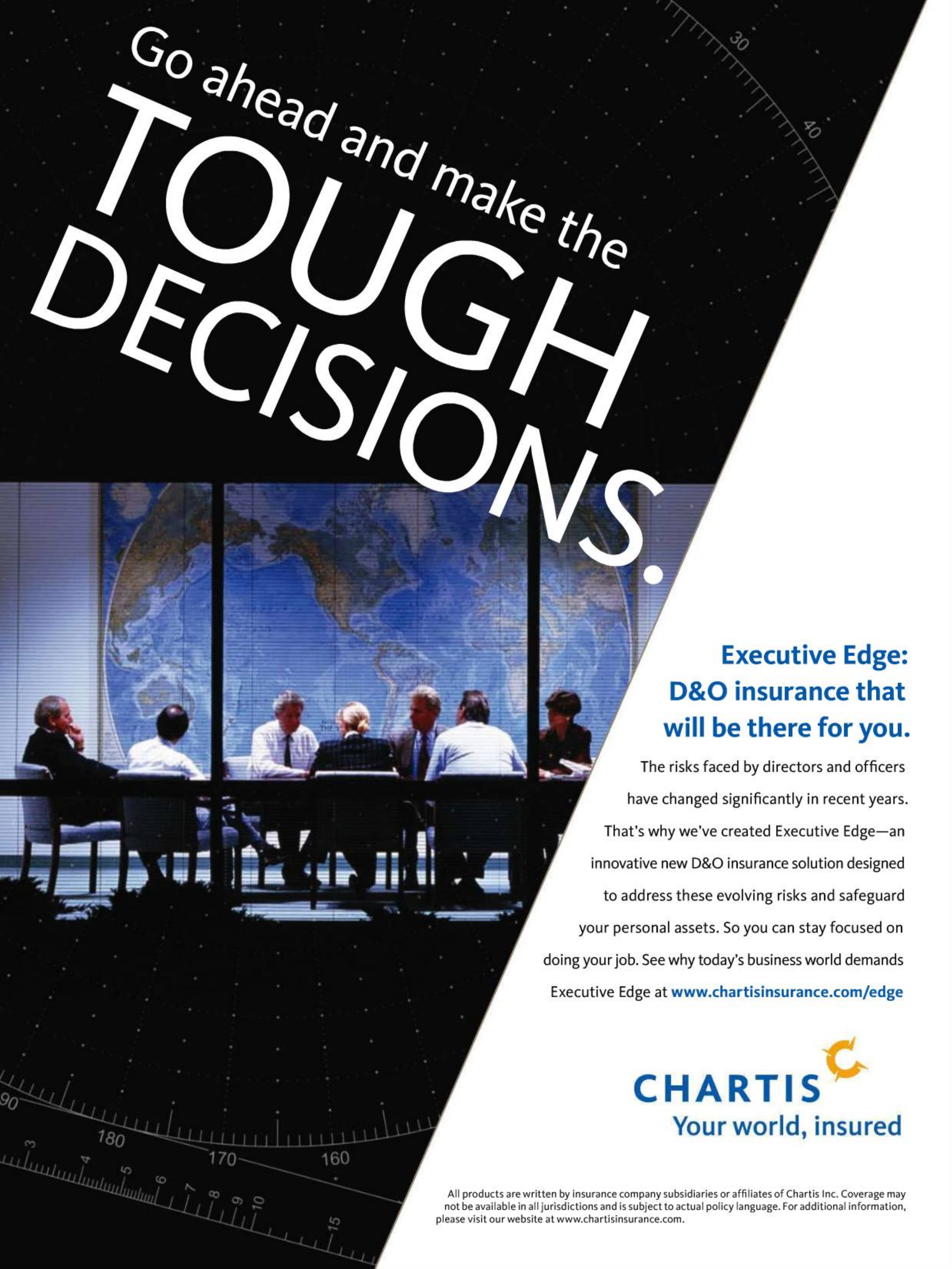


MOTOR TREND'S **2010 CAR OF THE YEAR.®**

*Based on Automotive Lease Guide, Inc. Percentage Forecast, Jul/Aug 2010 edition with a non-weighted 36-month residual value.
**Based on RDA Group's GQRS cumulative survey at 3 months of service in 3 surveys of 2009 Ford and competitive owners conducted 9/08-5/09.
†2010 EPA-estimated 23 city/34 hwy/27 combined mpg, Fusion S, I-4 automatic.



Drive one.


Go ahead and make the
TOUGH
DECISIONS.
Executive Edge:
D&O insurance that
will be there for you.
The risks faced by directors and officers have changed significantly in recent years. That's why we've created Executive Edge—an innovative new D&O insurance solution designed to address these evolving risks and safeguard your personal assets. So you can stay focused on doing your job. See why today's business world demands Executive Edge at www.chartisinsurance.com/edge
CHARTIS
Your world, insured
All products are written by insurance company subsidiaries or affiliates of Chartis Inc. Coverage may not be available in all jurisdictions and is subject to actual policy language. For additional information, please visit our website at www.chartisinsurance.com.

Bloomberg Businessweek
Contents

August 9 — August 15, 2010
Bloomberg Businessweek



Pen Power
Livescribe turns handwriting into a digital record p84

Opening Remarks 7

KKR has always stood for the Wall Street idea that "value" could be created by taking a public corporation private. What does it mean for private equity when the quintessential firm goes public?

Global Economics 13

The new Silk Road
Trade between fast-growing emerging markets may eclipse their ties with the West

- Mideast nuclear power p14
- Israel: Torah or toil? p16
- Brazilians spend big in N.Y. p17
- Cooling the Swiss franc p17
- China may legalize strikes p18
- Ireland's debt sheriffs p19
- Tom Keene's EconoChat p19

Companies & Industries 21

Sputtering in China
Inflation is squeezing consumers. Carmakers are boosting output. Only price cuts move the metal

- Developing-world deals for AIDS drugs p22
- Appliances that can say what ails them over the phone p23
- Banks struggle to find qualified small business borrowers p24
- How big a fine will BP pay? p26
- In Brief p27

Politics & Policy 28

The VC-in-Chief
Under Obama, the U.S. is spending billions on cleantech startups. Can it pull the plug on the losers?

- Obama's impact on Detroit p30
- The furor over insurers and military death benefits p31
- An off-Target campaign gift p32
- The apparent hex on the House Ways & Means chair p32

Technology 35

I want my 84 percent
Paul Ceglia, a wood-pellet fuel maker, says a 2003 document entitles him to a huge chunk of Facebook

- Videoconferencing for the masses p36
- Cash, check, or smartphone p37
- Will question-asking become a big business? p38
- Bing's mobile architect p39

Markets & Finance 41

Cerberus' gun play
With firearm sales slipping, the firm's investment in gun makers looks like a bad bet

- A Chinese ratings rival p42
- Why hedge funds are wary p43
- Rothschild's China chief p45
- Charlie Rose talks to Wilbur Ross p46
- Miners merging for gold p48
- Bid & Ask: The week's deals p49

Jobs 51

Help wanted—for now
The jump in temp workers isn't translating into permanent jobs as companies fret the future

- Oil-fueled stimulus spending keeps Norway working p52
- In some industries, the long-term jobless are left behind p53
- The White House's Christina Romer on job creation p54
- Passion over paychecks p55



Can we still afford it? Inside the great tax-cut debate

Features 56

The Bush Tax Cuts
Despite terrifying deficits, most economists now say the U.S. is too weak to let them expire p56

Is the CEO Wearing Any Clothes?
Dov Charney *is* American Apparel. The chain needs more than charisma and controversy to survive p62

The Education of Goldman Sachs
For-profit college operator EDMC has done well for its biggest backer. Not so for its students p66

How to Get Ahead in Vegas
Gary Loveman turned Harrah's into the world's biggest gaming company. Then came the crash p70

Etc. 77

America's Most Exclusive Club
A select few are saying no to the cell phone, and they're making the world run on their time

- **Work Drug** In a Starbucks world, do Folgers and Maxwell House stand a chance? p80
- **One True Thing** A necklace that works in the workplace p81
- **Navigator** The best off-peak destinations for a late summer vacation p82
- **Hands On** With Livescribe's smartpen your handwritten notes go digital p84
- **Next Life** Joseph Diaz's trip from real estate to launching a travel magazine p85
- **The Stack** Is the Web making the world better or worse? Yet another voice heard p86
- **Hard Choices** Seventh Generation co-founder Jeffrey Hollender on saying no, and then yes, to selling his wares to Wal-Mart p88

COVER: NIGEL PARRY/CPI; THIS PAGE: BUSH: TIM SLOAN/AFP/GETTY IMAGES

Index



A

Aardvark 38
ABB 17
Accenture (ACN) 53
Adelson, Sheldon 70
Agüera y Arcas, Blaise 39
American Airlines (AMR) 17, 82
American Apparel (APP) 62
American Express (AXP) 37
AMP Capital Investors 13
Anadarko Petroleum (APC) 26
Anoto 84
Answers Corp. (ANSW) 38
Aozora Bank 41
Apollo Management 70
Apple (AAPL) 17, 36
Areva 14
Argonaut Macro Partnership 43
Arrow Energy 45
AT&T (T) 37
August Capital 38
Avis Budget Group (CAR) 48
Aviva Investors 13
AWB 48

B

Bank of America (BAC) 24, 48
Bank of Montreal 48
Bank of Nova Scotia (BNS) 62
BankUnited 46
Banyan Capital 43
Barclays (BCS) 37
Barnes & Noble (BKS) 27
Barrick Gold (ABX) 48
Benchmark Capital 38
Best Buy (BBY) 32, 84
Bilton, Nick 86
Binion's Horseshoe 70
BlackRock (BLK) 42
Blackstone Group (BX) 7
BMO Capital Markets 48
BNP Paribas 45
Bowers & Wilkins 17
Boyd Gaming (BYD) 70
BP (BP) 26
Buffett, Warren 77

C

Carr, Nicholas 86
Caterpillar (CAT) 13
Ceglia, Paul 35
Cerberus Capital Mgmt. 41
ChaCha 38
Charney, Dov 62
Cheung Kong Infrastructure Holdings 48
China South Locomotive & Rolling Stock 13
China Analytics 42
China Railway (CRWOF) 13
Chrysler 30, 41
Cisco Systems (CSCO) 36
Citic Securities 45
Compañía Mexicana de Aviación 27
comScore 39
Craigslist 35, 38
Crédit Agricole 45
Credit Suisse (CS) 43
Cuomo, Andrew 31
Customer Growth Partners 62

D

Dagong Global Credit Rating 42
Dell (DELL) 36
Deloitte 55
Deloitte & Touche 62
Discover Financial Services (DFS) 37
Dollar Thrifty Automotive Group (DTG) 48
DPMS Firearms 41
Dudley, Robert 26
DynCorp International (DCP) 41

E

eBay (EBAY) 38
EDF 48
Education Management (EDMC) 66
Edward Jones 80
Electronic Arts (ERTS) 66
Embraer (ERJ) 13
Emirates 82
Endeavor Acquisition 62
ESPN 66

F

Facebook 32, 35, 38, 77
Filmyard Holdings 48
Fitch Ratings 42
Flickr 39
Fluther.com 38
Ford (F) 30, 45
Freedom Group 41
Freeman & Co. 45

G

GameRecruiter 66
Gawker.com 62
GE (GE) 14
General Motors (GM) 21, 30, 41
Genzyme (GENZ) 27
GE Transportation 51
Ghosn, Carlos 21
Gilead Sciences (GILD) 22
Gimme Credit 41
GlaxoSmithKline (GSK) 22
Goldman Sachs (GS) 66
Goodbody Stockbrokers 19
Google (GOOG) 38, 39
GrainCorp. 48
Greenhill Caliburn 48
Guan, Jianzhong 42

H

Harman Intl. (HAR) 27
Harrah's Entertainment 70
HCL America 53
Hertz Global Holdings (HTZ) 48
Hewlett-Packard (HPQ) 36
Hilton, Paris 77
Hitachi (HIT) 14
Holder, Eric 26
Home Depot (HD) 37
Honda (HMC) 18, 21
HSBC (HBC) 13, 45, 48
Huawei Technologies 13
Hunch 38
Huntington National Bank (HBAN) 24

I

IBISWorld 41
IBM (IBM) 48
IDC 36
IHS CERA 14
Interjet 27

J

J.Crew (JCG) 81
JetBlue (JBLU) 82
J.M. Smucker (SJM) 80
Johnson & Johnson (JNJ) 22
JPMorgan Chase (JPM) 24, 43
Julius Baer Holding 17

K

KazahkGold Group 48
Kelsey Group 38
Kerry, John 32
KeyBanc Capital Markets (KEY) 62
Khorana, Shami 53
Kimber Kable 17
Kinross Gold (KGC) 48
Kirk, Ron 15
KKR (KFN) 7
Korean Electric Power (KEP) 14
Kraft Foods (KFT) 80
Kravis, Henry 7

L

Las Vegas Sands (LVS) 70
Leeds Equity Partners 66
Lihir Gold (LIHR) 48
Lion Capital 62
Livescribe 84
Louis Vuitton 17
Loveman, Gary 70

M

Manpower 51
Marcopolo 13
MasterCard (MA) 37
McCain, John 31
McIntosh 17
Merck (MRK) 22
Merk Investments 17
Merrill Lynch (BAC) 48
MetLife (MET) 31
MGM Resorts (MGM) 70
MG Rover 45
Microsoft (MSFT) 39
Mills, Wilbur 32
Mitsui Oil Exploration 26
Mittal (MT) 46
Moody's Investors Service (MCO) 42

N

Nanjing Automobile 45
NBC 66, 86
Neiman Marcus 66
Newcrest Mining 48
New Hampshire Community Loan Fund 24
Newmont Mining (NEM) 48
New York Stock Exchange (NYX) 7, 62
Nissan Motor (NSANY) 21

O

Obama, Barack 28, 30
Omnicare (OCR) 48
OppenheimerFunds 51

P

Palm (PALM) 36
Paranapanema 49
PeerPong 38
Perella Weinberg Partners Xerion 43
PerTrac Financial Solutions 43
PetroChina (PTR) 45
Pfizer (PFE) 22
Pilla Performance Eyewear 51
Polycom (PLCM) 36
Polyus Gold (OPYGY) 48
Prada 17
Procter & Gamble (PG) 27
Prokhorov, Mikhail 77
Providence Equity Partners 66
Prudential Financial (PRU) 31

Q

Quora 38

R

Radvision 36
Random House 86
Rangel, Charles R. 32
Red Back Mining 48
Research in Motion (RIMM) 27
Retrevo.com 77
Robert Half International (RHI) 51
Romer, Cristina 54
Ross, Wilbur 46
Rothschild 45
Royal Dutch Shell (RDSA) 45
Rustic Crust 24

S

SAIC Motor 21
Sanofi-Aventis (SNY) 27
Saudi Railways Organization 13
Schwarzman, Stephen 7
Seventh Generation 88
Shanghai Automotive Industry 45
Shapiro, Ofer 36
Sherry-Lehmann. 17
Shinseki, Eric 31
Shirky, Clay 86
Sirclelt 38
Skype 36
Smiley, Tavis 77
Smith Electric Vehicles 28
Sony (SNE) 66
Standard & Poor's (MHP) 42
Starbucks (SBUX) 80
Stereo Exchange 17
Stock Resource 48
Stone & McCarthy Research Associated 42
Sukhoi 13
Sullivan & Cromwell 77
Svanberg, Carl-Henric 26
Swatch 17
Symphony IRI Group 80

T

Talecris Biotherapeutics (TLCR) 41
Target (TGT) 32, 37
Tata Group 13
Theragenics (TGX) 51
The Smiley Group 77
T-Mobile 37
Toyota Motor (TM) 21
TPG Capital 70
Twitter 77, 86

U

UBS (UBS) 42, 45
UniCredit Group 51

V

Vale (VALE) 13, 49
Verizon Wireless 37
Vidyo 36
Visa (V) 37
Volaris 27
Volkswagen 21
Volvo 45

W

Wainhouse Research 36
Wal-Mart Stores (WMT) 17, 37, 80, 88
Walt Disney (DIS) 48, 82
Washington Post (WPO) 27
Waterstone Capital Management 43
WellsFargo (WFC) 24
Wilsons Auctions 19
Wyly, Charles 32
Wyly, Sam 32
Wynn Resorts (WYNN) 70
Wynn, Steve 70

Y

Yahoo! (YHOO) 38
YouTube (GOOG) 32
Yu, Jennifer 45

Z

Zhejiang Geely 45
Zuckerberg, Mark 35

How to Contact Bloomberg Businessweek

Editorial 212-617-6231 **Sales** 212-617-2900 **Circulation** 800-635-1200
Address 731 Lexington Ave., New York, NY 10022
Email bwreader@bloomberg.net **Fax** 212-617-9065

Letters to the Editor can be sent by e-mail, fax, or regular mail. They should include address, phone number(s), and e-mail address if available. Connections with the subject of the letter should be disclosed, and we reserve the right to edit for sense, style, and space.

Smarter business for a Smarter Planet:

What if foresight were 20/20?

Today, CFOs are under more pressure than ever before to use information to fuel better business decisions. But is the information at their fingertips actually helping them do that? Many companies find themselves accessing information through management processes that can be slow, disconnected, error prone or all of the above. IBM Cognos® solutions give your finance team information they can trust, when and how they need it. Allowing them to use analytics to anticipate performance gaps, prioritize resources, gain insight into profit and growth—and make better decisions, faster. Companies have already used IBM Cognos solutions to reduce financial planning cycles by 77% and reporting cycles from days to minutes.

A smarter business needs smarter software, systems and services.
Let's build a smarter planet. ibm.com/cognoscfo

IBM, the IBM logo, ibm.com, Smarter Planet and the planet icon are trademarks of International Business Machines Corp., registered in many jurisdictions worldwide. Other product and service names might be trademarks of IBM or other companies. A current list of IBM trademarks is available on the Web at www.ibm.com/legal/copytrade.shtml. © International Business Machines Corporation 2009.

To see our commitment to biodiversity, just follow our tracks.

At APP, we take our responsibility as stewards of the environment seriously. We support programs that preserve 261,930 acres in the Senepis Tiger Sanctuary, 24,710 acres spanning the Taman Raja Nature Preserve, 425,019 acres in the Giam Siak Kecil Biosphere Reserve which is recognized by the UNESCO Man and the Biosphere Programme, and the Kutai Orangutan Programme. Because we understand that for our business to thrive, the world in which we operate must thrive as well.



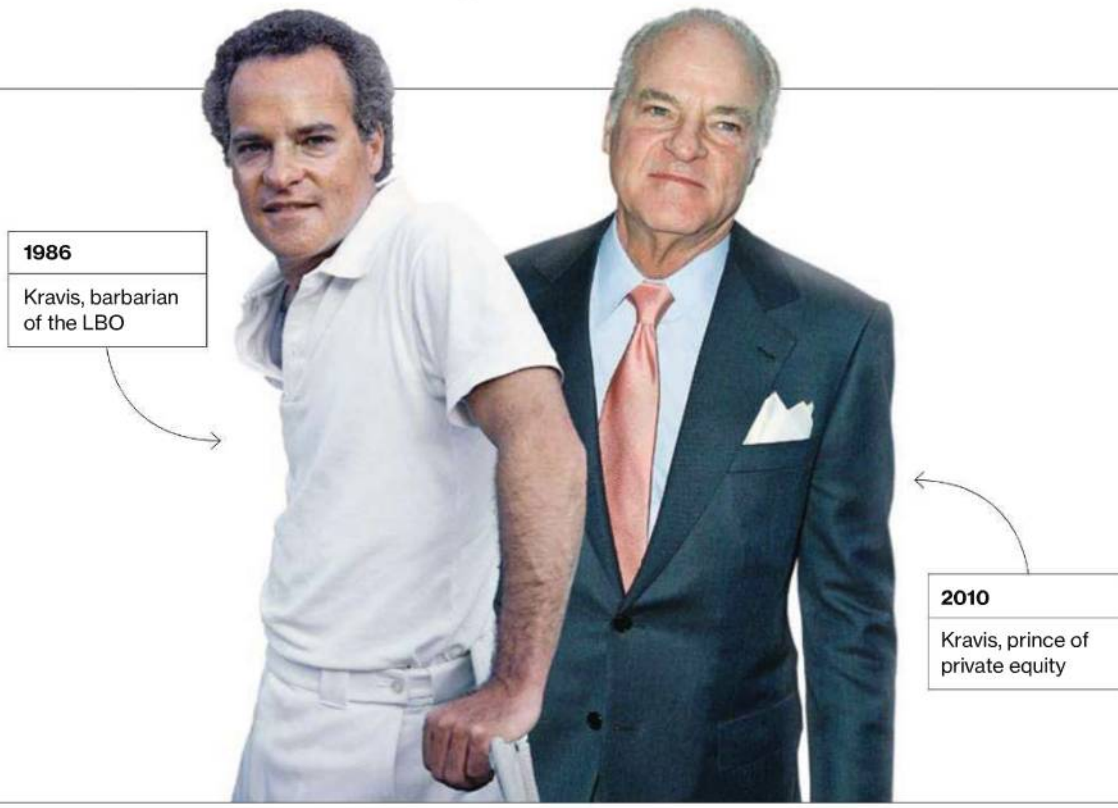
APP CARES

www.asiapulppaper.com

To find out more please visit us at www.asiapulppaper.com
or email us at environment@app.co.id

Opening Remarks

What Is Henry Kravis Telling Us?



FROM LEFT: SLIM AARONS/HULTON ARCHIVE/GETTY IMAGES; JIMI CELESTE/PATRICK MCMULLAN/SIPA PRESS

KKR has always stood for the idea that private equity is a better way. So what does it mean that KKR is now publicly traded?
By Roger Lowenstein

Three years after KKR announced it was going public, its shares are finally trading on the New York Stock Exchange. Once, the parent of Kohlberg Kravis Roberts stood for a peculiar Wall Street mythology, the notion that "value" could be created by the simple act of taking a public corporation private. In its wake came a flood of imitators–the entire private equity industry–as well as institutional investors willing to ante up the necessary capital.

Now the quintessential private equity firm is a public company, an oxymoron that raises vexing questions. First, if KKR is synonymous with the idea that private equity is a better, more efficient form of corporate organization, why did KKR decide to go public?

Second, is there any evidence that private equity is better? Does society benefit when public companies go private? Do investors? Or does the process only serve the interests of the fund managers who pocket those gargantuan fees?

Third, whatever happened to Congress's plan to end the tax break that benefits managers of private equity firms, hedge funds, and the like? The plan has been kicking around for years. Will Washington ever summon the courage to tax these billionaires at the same rate as other wage earners?

Private equity has its roots in the leveraged buyout fad of the 1980s. Its premise was that chief executive officers of public companies were not sufficiently "incented" for success, thus let their organizations drift. Perhaps a small division of a big public corporation was being overlooked or starved for capital and would perform better if it were spun off and became the sole focus of a new set of manager-owners. Or maybe the CEO's compensation was so insulated from company performance, or so fattened with guaranteed bonuses, that he had no reason to make his corporation perform.

So-called barbarians like Henry Kravis, a KKR founder, had a remedy for that: the leveraged buyout, or LBO. Kravis and other apostles of private equity preached the advantages of going dark. Give managers a piece of the action, they said, and surely their capitalist juices would stir. Since not even the KKRs of the world, with their dutiful tribes of institutional investors, had sufficient capital to replace the public's equity, most of the enterprise would be financed with debt.

Not that this was cause for alarm. Plenty of debt meant plenty of deductible interest, which cut the tax man's take. Better still, leverage magnified gains. Admiring scholars added a beguiling coda: High levels of debt were actually a plus, since the ever-present risk of bankruptcy would

Opening Remarks

The private equity industry as a whole beats the stock market only by a modest amount, says Steven Kaplan of the University of Chicago Business School. After fees, you're better off in an S&P 500 index fund.

keep managerial minds focused. In his celebrated 1989 essay, Harvard's Michael Jensen went so far as to predict the "Eclipse of the Public Corporation."

Jensen's enthusiasm proved to be the peak. As early deals begat high profits, capital rushed in, pushing buyout prices higher. LBO deals such as KKR's $31 billion acquisition of RJR Nabisco, also in 1989, did not make basic financial sense–they carried too much debt–though of course that didn't cool the dealmakers' ardor. In a trend that troubled even Jensen, buyout kings, supposed paragons of capitalist virtue, were pocketing princely fees up front (rather like some of the slothful public CEOs they were replacing) and irrespective of their eventual results.

In 1990 the buyout market crashed. LBOs with too much "L" experienced the dubious charms of bankruptcy. Then, after a mild recession, buyouts returned. This second wave was distinguished by two subtle changes.

First, CEOs at public companies, under fierce pressure to raise their stock prices, were no longer so slothful, if ever they had been. They were cutting costs, laying off workers, and spinning off divisions that didn't fit–the same tricks employed by fund managers during leveraged buyouts. This left fewer companies susceptible to easy improvement via LBO engineering.

The second change emboldened the buyout artists. Miraculously, they were LBO firms no more; they had been reborn as "private equity." The new name conjured an image of baronial elegance, as if merely to invest with a Kravis or Stephen Schwarzman was to enter a satiny world of quiet money and managerial brilliance.

Ultimately, Schwarzman bolted for the grubbier and even more bountiful world of public markets; the Blackstone Group, the private equity firm he co-founded in 1985, got a jump on KKR by going public in 2007. Evidently, buyout kingpins are anxious for an exit strategy, which public shares provide.

The industry has never escaped this boom-and-bust pattern. Strong returns in the early 1990s attracted competition, leading to a crowded field and poorer returns later in the decade. The cycle was repeated in the 2000s, as deals struck in the easy-credit environment of 2006-07 collapsed, pummeling institutional investors.

How does the record look overall? Steven Kaplan, a professor at the University of Chicago Business School, has been studying private equity returns since the late 1980s. Kaplan's findings: Some firms consistently led the pack, although the industry as a whole beats the stock market by only a modest amount. And after fees, an outside investor would do as well or better with his or her money in an index fund that tracks the Standard & Poor's 500-stock index. As Kaplan put it in a recent paper, private equity "did not seem to outperform S&P net of fees." Investors, on average, have been overpaying for the industry's supposed prowess, so the marketplace has begun to force private equity fees down, especially the fees charged up front.

There is no doubt, Kaplan adds, that private equity firms make operational improvements. However, these gains are given back at the outset in the premiums paid to acquire targets. And as public company management has gotten better, the gap between private and public efficiency has narrowed.

In sum, going private adds modest efficiencies–benefits that are reaped by selling shareholders and the buyout firms. These benefits are probably temporary–since corporations go private only in order to go public again a few years later–and largely offset by the heavy burden of increased debt. As a social good, this isn't exactly on a par with curing cancer.

Which brings us to the place where private equity really can contribute to society: by paying a fair share of taxes. While the federal government taxes ordinary income at up to 35 percent, capital gains on investments held for more than one year are taxed at only 15 percent, a low rate designed to attract investment in capital markets.

Managers of private equity funds and other investment partnerships enjoy an undeserved exception. The performance fee they charge investors, typically 20 percent of profits, is treated as a capital gain and taxed at the lower rate. This makes no economic sense: An investor has the same incentive to participate regardless of the tax paid by the manager. It only makes sense if you are Henry Kravis and prefer to pay less.

The House of Representatives has three times voted to end this unwarranted privilege. After the recent financial crisis, the Senate seemed likely to concur. Then industry lobbyists stormed Congress. The matter now rests with the Senate Finance Committee, with action a long shot this year.

Since nothing is more arbitrary than the proper rate at which to tax, the only sure principle is consistency: What one party pays, so should the other. No great industry is at stake here. Private equity is hardly the engine of job creation its flag-waving lobby maintains, and the industry will survive. What is at stake is fairness: Billionaire financial engineers–whether they are being called barbarians, LBO dealmakers, or private equity princes–should pay the same rate as the rest of us. B



1. CNBC streaming news and the CNBC logo are provided for informational purposes only under a license agreement with CNBC, Inc. Neither E*TRADE FINANCIAL nor any of its affiliates are responsible for its content and no information presented constitutes a recommendation by E*TRADE FINANCIAL or its affiliates to buy, sell or hold any security, financial product or instrument discussed therein or to engage in any specific investment activity.

2. **For information and details about Power E*TRADE, please visit www.etrade.com/power.** To qualify for Power E*TRADE tools and trading platforms, you must execute at least 30 stock or options trades during a calendar quarter. To continue receiving access to active trader tools and trading platforms, you must qualify by executing at least 30 stock or options trades by the end of the following calendar quarter. Commissions for stock and options trades are $9.99 with a 75¢ fee per options contract. To qualify for $7.99 commissions for stock and options trades and a 75¢ fee per options contract, you must execute at least 150 stock or options trades per quarter.

Securities products and services are offered by E*TRADE Securities LLC, Member FINRA/SIPC.

System response and account access times may vary due to a variety of factors, including trading volumes, market conditions, system performance and other factors.

©2010 E*TRADE FINANCIAL Corp. All rights reserved.



Jeep is a registered trademark of Chrysler Group LLC

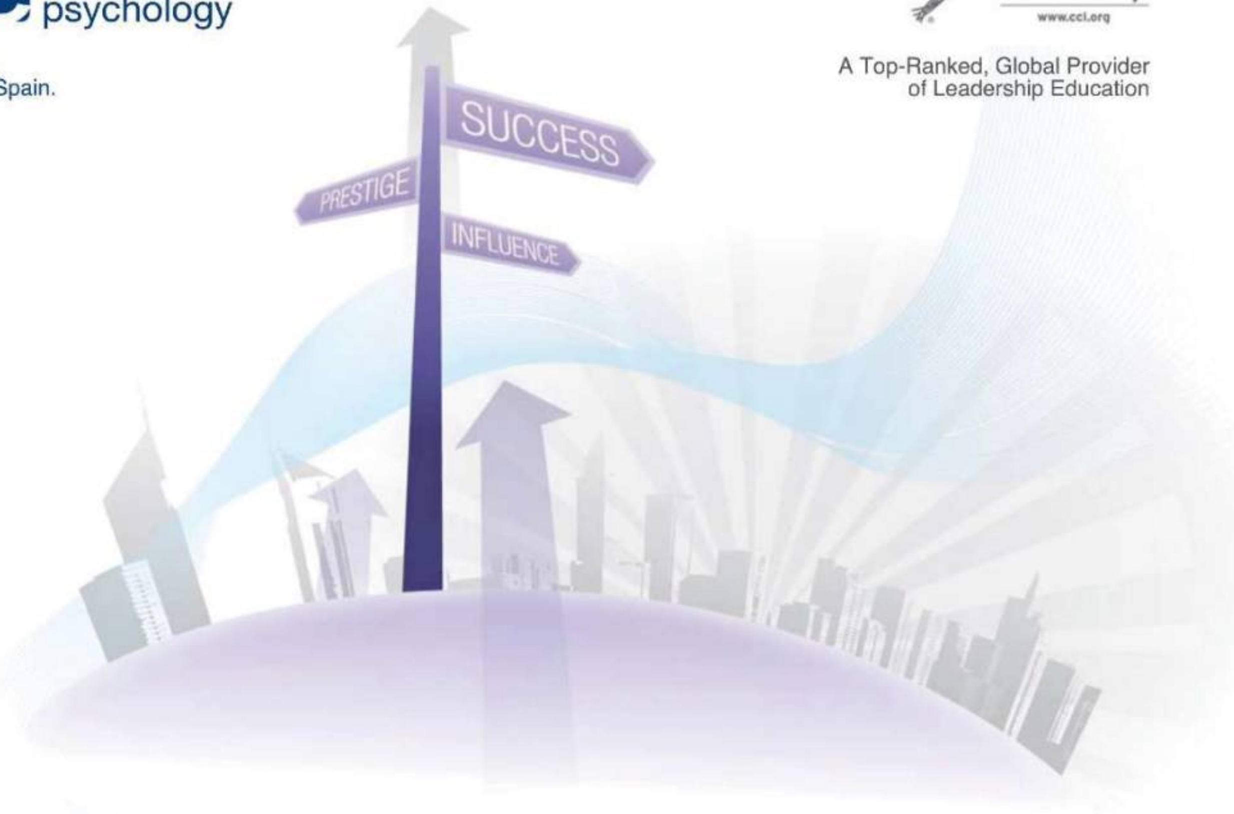

PLASTIC CANNOT
BE FORGED.
THIS IS THE 2011 GRAND CHEROKEE
Jeep
THE THINGS WE MAKE,
MAKE US.

ie school of psychology

Madrid. Spain.

Center for Creative Leadership
www.ccl.org

A Top-Ranked, Global Provider
of Leadership Education



"...all relevant social knowledge and interpersonal skills for developing a career in leadership within any type of organization..."

Master in Organizational Leadership

In partnership with the **Center for Creative Leadership.**

Acquire interpersonal understanding, influencing skills and systems thinking.

Combine your professional obligations with **top education in leadership.**

In association with IE Business School, ranked among the top business schools in the world.

IE School of Psychology | Madrid. Spain. | Tel. 91 568 96 10 | mol@ie.edu | **www.ie.edu/mol**

Contents ▶ The Mideast's nuclear power boom 14 ▶ Israel's unemployed ultra-Orthodox 16 ▶ Brazillionaires hit Manhattan 17 ▶ Extreme Swiss currency moves 17 ▶ Chinese workers may gain the right to strike 18 ▶ Ireland's debt-collecting sheriffs 19 ▶ Robert Reich on jobs 19 ● Edited by Christopher Power

Global Economics



The new global trade route runs through Mali, where China is investing

There's a New Silk Road, and It Doesn't Lead to the U.S.

▶ **Trade routes bring Brazilian buses to Egypt and Chinese trains to the Mideast**

▶ **"There are now massive trading connections between the emerging markets"**

As the U.S. emerges from the recession, American investors often wonder where the growth is going to come from. Perhaps they should talk to Ruben Bisi, international operations director for **Marcopolo**, Brazil's biggest bus maker. It's having a banner year, with revenue up 47 percent so far. You won't see Marcopolo buses in the U.S., though. They're cruising the highways and city streets of Argentina, Colombia, Mexico, Egypt, India, China, and South Africa. Brazilians often have a better relationship with these customers than big multinationals do, says Bisi. "We are from an underdeveloped country as well," he explains. Almost 40 percent of Marcopolo's sales of $1.1 billion come from outside Brazil: It sold 460 buses to South Africa for the World Cup.

Marcopolo is a traveler on what Stephen King, chief economist of HSBC, has dubbed "the new Silk Road"—a 21st-century version of the trade routes that crisscrossed Asia almost 2,000 years ago, linking merchants in China to their counterparts in India, Arabia, and the Roman Empire. The new Silk Road spans the globe, connecting companies and consumers in Latin America, the Mideast, Asia, and Africa, and generating some $2.8 trillion in trade, according to the World Trade Organization.

"We saw the same phenomenon with American and European companies 100 years ago"

King says emerging markets will grow about three times faster than rich nations this year and next. "There are now massive trade connections within the emerging markets," he says. "It means in one sense the emerging world is protected from the worst

SOPHIE CHIVET/AGENCE VU/AURORA

ravages of the developed world." The WTO estimates intra-emerging-market trade rose, on average, by 18 percent per year from 2000 to 2008, faster than commerce grew between emerging and advanced nations.

The developed world will increasingly compete with these fast-rising countries for resources like oil and iron ore. The established multinationals will also encounter new pressure from emerging-market rivals, many of them state-supported. Yet for Western and Japanese companies that are the best in their industries, the opportunities are great. One example: **Caterpillar**, the world's largest maker of construction equipment, raised its full-year earnings forecast last month on higher demand in developing countries for mining, energy, and rail equipment.

While the U.S. and other developed countries hope to find their place on the Silk Road, the central player is China. Chinese exports to the emerging world accounted for about 9.5 percent of its gross domestic product in 2008, compared with 2 percent in 1985, King figures. Last month the **Saudi Railways Organization** awarded a contract to **China South Locomotive & Rolling Stock** to supply 10 locomotives. The Mecca-Medina rail contract went to Beijing-based **China Railway Group**. Shenzhen-based **Huawei Technologies**, China's top maker of phone equipment, is investing $500 million in its research center in Bangalore. China Mobile, the world's biggest phone carrier, may soon invest in Africa.

India and Brazil are stepping up their efforts, too. India's **Tata Group** was one of the largest investors in sub-Saharan Africa in the six years through 2009, according to the Organization for Economic Cooperation & Development. Many Silk Road companies are becoming aggressive acquirers. "We saw the same phenomenon with American and European companies 50 to 100 years ago as they went global," says Shane Oliver, head of investment strategy at AMP Capital Investors, which manages about $95 billion in Sydney. Brazilian mining company **Vale** has invested in three copper projects in Zambia and the Democratic Republic of the Congo. In April the company agreed to pay $2.5 billion for iron ore deposits in Guinea.

Such trade used to be conducted in dollars and euros, even when the deals did not involve U.S. or European companies. Today companies in emerging markets are more willing to take reals, rupees, and, above all, yuan as the Silk Road economies prosper. "If emerging-market fundamentals continue to be superior," says Kieran Curtis, who helps oversee $2 billion at Aviva Investors in London, "there is the potential for serious currency appreciation against old-guard currencies."

With trade comes competition. About a third of the order book of Brazilian plane maker **Empresa Brasileira de Aeronáutica**, or Embraer, comes from emerging-market customers, up from 1 percent in 2005. Yet Embraer doesn't have the field to itself. The Brazilians are bracing for a fight from Russia's **Sukhoi** and **Commercial Aircraft Corporation of China**, which are both developing airliners. Traffic on the Silk Road is getting pretty heavy. —*Simon Kennedy, Matthew Bristow, and Shamim Adam*

The bottom line *Trading ties among developing nations are intensifying fast and may eclipse emerging-market ties with the West.*

6.4

PERCENT

Savings rate for American households in June. Americans are saving at the highest rate in 12 months, as workers worried about their jobs put off big purchases and cut down personal debt.

DATA: COMMERCE DEPT.



Energy

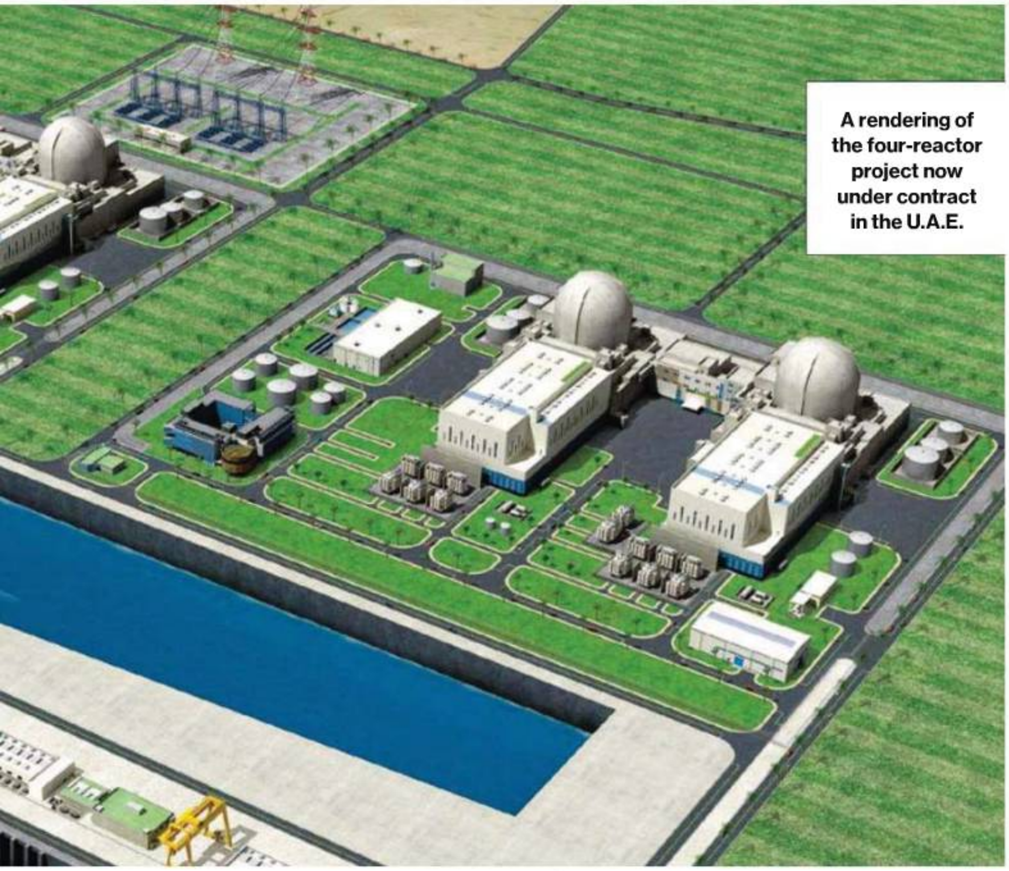
The Mideast Goes for The Nuclear Option

▶ Saudi Arabia, the Gulf, and Jordan hatch ambitious plans for reactors

▶ "There is more to this than straight economics"

Historically, it has been difficult for countries in the Mideast to build nuclear power plants. The idea of nuclear material being diverted from commercial reactors has always alarmed Washington, which for decades has used its clout in the region to keep the Mideast as nuclear-free as possible. Today the U.S. is leading the way in imposing sanctions on Iran's nuclear program. Israel also remains ready to protect its interests, as it did when its air force bombed the unfinished Osirak reactor in Iraq in 1981.

The situation is gradually changing, as Arab allies of the U.S. petition Washington to bless their plans for civilian nuclear programs. The U.S. is proving pliable, since the programs do not



A rendering of the four-reactor project now under contract in the U.A.E.

appear to have sinister intent, at least in the medium term, and offer a business opportunity for multinationals such as **General Electric**.

Saudi Arabia and the United Arab Emirates need to satisfy a growing hunger for electricity. In Abu Dhabi, electricity demand grew 11 percent just between 2008 and 2009. The interest in nuclear energy has in part been sparked by a shortage of natural gas, the usual fuel for electric power plants. Without enough gas, the Saudis and the Gulf Arabs have been burning oil to generate power, which is inefficient and polluting. These countries also consider themselves energy specialists and want to prepare for an era when carbon emissions may be penalized. "There is more to this than straight economics," says Ian Jackson, a nuclear specialist at London's Chatham House think tank. "It is clearly about strategic energy positioning."

Among the Gulf states, the United Arab Emirates is furthest down the nuclear road. At yearend, the U.A.E. concluded a $20 billion deal for four nuclear plants with **Korean Electric Power**, which beat GE and France's **Areva** on price. The U.A.E. has also agreed with the U.S. on strict safeguards, which include forgoing any domestic uranium enrichment or reprocessing of spent fuel. "They are the poster child for nukes in the Middle East," says Mark Hibbs, a nuclear analyst at the Carnegie Endowment for International Peace in Washington.

Not to be outdone, the Saudis recently said they would build a city specializing in nuclear and renewable energy, a concept that appears to be modeled on Masdar, Abu Dhabi's planned showcase green metropolis. The Saudis say they will spend some $80 billion on added power capacity over the next decade, with a big chunk possibly coming from nuclear facilities. "Use of nuclear in electricity will free more oil for exports and more gas for development," says Anas Alhajji, chief economist at NGP Energy Capital in Irving, Tex. With the Arab world's largest economy and a fast-growing population, the Saudis could prove to be the regional leaders in nuclear and other energy technologies, says Leila Benali, an analyst at energy consultants IHS CERA in Paris. "The Saudis continue to position themselves so they can play a leading role in the sector in 20 to 30 years' time," she says.

The most surprising would-be entrant is Jordan. Though the kingdom lacks the plentiful coffers of the Gulf petrostates, it wants to take advantage of its recent, large discoveries of uranium to become a nuclear energy center. Jordan's program will be devoted to generating electricity and "has no military uses whatsoever and could in no way be a threat to anybody," says Khalid Touqan, chairman of the Jordanian Atomic Energy Commission.

The prospect of future deals has sparked huge interest among nuclear suppliers. GE is firmly ensconced in the region. Saudi Arabia is its biggest customer for conventional power generation equipment, and the American company hopes its longstanding partnership with **Hitachi** will give it an edge in landing future nuclear contracts in the Mideast. "Saudi is obviously of interest to us," says Daniel Roderick, senior vice-president for nuclear projects at GE-Hitachi. "We're interested in Kuwait, we're interested in a lot of different countries there that are in various stages of their nuclear programs."

There is still much haggling to do on where the nuclear fuel will come from and how best to prevent proliferation. The U.S. is reluctant to permit states in the region to enrich uranium, which can then be used for nuclear weapons, or to reprocess fuel, which can yield plutonium for bombs. What helps keep things under control is that these countries cannot build plants on their own and need outside expertise to pursue their nuclear dreams. Carnegie Endowment's Hibbs figures that some of the wealthy Gulf states will

Quoted

"One of the more legitimate complaints against U.S. trade policy and previous Administrations, both Democratic and Republican, is that a lot of people felt like we have not been willing to hold our trading partners' feet to the fire."
—U.S. Trade Representative Ron Kirk on the U.S.'s decision to file a labor rights violation case against Guatemala



FROM TOP: EMIRATES NUCLEAR ENERGY CORP/AP PHOTO; JOSHUA ROBERTS/BLOOMBERG

Global Economics

succeed in going nuclear, while the high costs and risks will exclude the rest.

Looming over all this activity is the prospect of a nuclear-armed Iran. While the rulers of the Gulf states and Saudi Arabia seem genuinely interested in peaceful nuclear development, they know reactors can provide needed knowhow if tensions with their ancient Persian enemy escalate. "It's a long-term hedging option," says Hibbs, "particularly in light of concerns that U.S. security guarantees will become weaker." —*Stanley Reed, with Nayla Razzouk and Rachel Layne*

***The bottom line** The Mideast may meet its growing energy needs through nuclear power. That gives power plant companies like GE a big opportunity.*

Labor

To Work or to Study? In Israel, It's a Hard Choice

▶ Israel wants ultra-Orthodox men to work: Less time for the Torah

▶ "The burden on the working population will grow and grow"

Moshe Linker spends his days studying Jewish religious texts in Jerusalem, supporting his three children with a seminary stipend, state child payments, and his wife's teacher salary.

Linker isn't alone. Almost 60 percent of Israel's estimated 100,000 ultra-Orthodox men of working age don't have jobs. They have prompted Bank of Israel Governor Stanley Fischer and Finance Minister Yuval Steinitz to assert that the *haredim*, as they are called in Hebrew, may impede Israel's prosperity. The low rate of employment is putting pressure on the economy in a way that is "not sustainable," Fischer told reporters in Jerusalem in July. About 50,000 ultra-Orthodox men who study full-time are also exempted from service in the military, which means they don't participate in an institution that has driven Israel's technology boom and helped transform its economy. (All the *haredim* together—men, women, and children—come to about 700,000.)

Linker, 39, says he makes an essential, if nonfinancial, contribution: "We live in a Jewish nation and provide it with the



spiritual energy to keep it going. That's at least as important as the economy." According to a June 30 Finance Ministry report, the country lost an estimated $1 billion in additional economic output last year because so few able-bodied *haredim* worked at paying jobs. "Every citizen gives some and gets back some," says Omer Moav, an economics professor at the Hebrew University of Jerusalem. "An average *haredi* family gives a small amount and gets a lot. The burden on the working population will grow and grow."

For people such as Linker and Hillel Mann, a 36-year-old student with five children, leaving the yeshiva, or Jewish seminary, is tantamount to forsaking their way of life. "The sages say that someone who even for one day abandons Torah study will find it extremely difficult to return," says Mann.

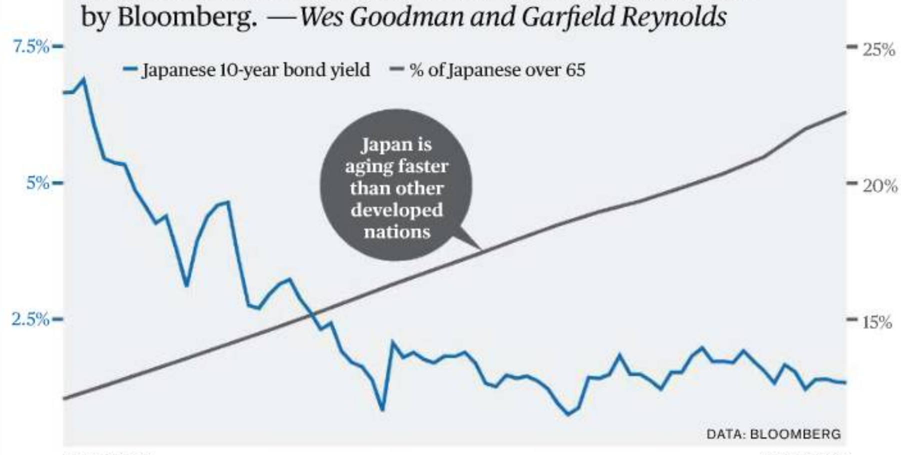
Undeterred, the government is proposing to spend more on job-placement, educational, and vocational programs to boost ultra-Orthodox males' labor market participation to about 63 percent. That may lift annual economic growth by between 0.5 and 0.75 percentage points for the next 15 years, says Eugene Kandel, Prime Minister Benjamin Netanyahu's top economic adviser. "This group has a lot of potential in it because they know how to learn," he adds.

Because most *haredi* men get no more than a basic education in math and science, even those who want to work can't get jobs in the technology industry. Those who do serve in the army don't qualify for the high-tech units that produce entrepreneurs. One attempt to address this is an army program called "Wisdom in Khaki" that offers *haredi* men training in computer and communications work. The men apply these newly acquired skills in the intelligence branch of the army. When they finish their service they are equipped to find high-tech jobs. ➜

Demographics

Japan's Elderly Love Those Bonds

Japanese bonds are approaching their lowest yields in seven years as the aging population snaps up government securities. Older Japanese are conservative investors—a break for the government, which doesn't have to hike rates. Japan's 10-year yields are the lowest of 31 bond markets tracked by Bloomberg. —*Wes Goodman and Garfield Reynolds*



DATA: BLOOMBERG

AHIKAM SERI/BLOOMBERG

Global Economics



Sherry-Lehmann's Galvani: "I sell a lot to Brazil"

RAMIN TALAIE/BLOOMBERG

Many *haredim* would get a job if workplaces "appropriate to the ultra-Orthodox culture and rules of conduct" could be created, says Benjamin Fefferman, director of the planning, research, and economics administration at the Ministry of Industry, Trade & Labor. Says Moshe Gafni, a member of the ultra-Orthodox political party United Torah Judaism: "We are not parasites. The *haredim* want to work, but we don't want to change the way we live." —*Gwen Ackerman and Alisa Odenheimer*

The bottom line *The Israeli government is trying out some innovative programs to boost the labor participation of ultra-Orthodox males.*

Consumer Spending

In New York, Prada Speaks Portuguese

▶ Newly rich Brazilians flood Manhattan's toniest shops

▶ Selling $100,000 stereos: "Brazil has really hit my radar screen"

For a firsthand account of how Brazilians are changing New York shopping, talk to Ana Paula Galvani, a Portuguese-speaking saleswoman at the **Sherry-Lehmann** wine store on Park Avenue. Tourists from Brazil stop by daily and don't hesitate to buy $1,000 bottles. "I sold 30 cases of 2009 Bordeaux futures in the last two weeks," says Galvani, a native of Mirandópolis, in São Paulo state. "I sell a lot to Brazil." A 12-bottle case of 2009 Château Margaux Grand Cru Classe Premier costs $15,540 for delivery in 2012.

You could produce a good index of which countries fortune has smiled on by tracking the languages spoken in the aisles of **Louis Vuitton** on 57th and Fifth, the interior of the **Apple** store on Prince Street, and the lobby of the **Jumeirah Essex** hotel on Central Park South. The Japanese were once the shopping kings. Then the Koreans, the Chinese, and the Russians. Now Brazil's economy is experiencing its fastest growth in 15 years, and the currency has doubled against the dollar since 2003. Armed with high disposable income, Brazilians have descended on New York.

The **Prada** store in SoHo has at least three Portuguese speakers on staff to cater to Brazilians. David Wasserman, co-owner of **Stereo Exchange** on lower Broadway, just sold a $100,000 home theater system to a customer from São Paulo. "Brazil has really hit my radar screen," he says. In a country of more than 193 million people, the number of millionaires in 2009 jumped 19 percent, to 126,882, from 2008, according to data compiled by Boston Consulting Group.

About 359,000 Brazilian tourists traveled to New York last year, up 41 percent from 2007. **American Airlines** is adding 11 flights a week between the U.S. and Brazil starting in November. Fashion stylist Patricia de Azevedo Camargo Araujo of Santos, Brazil, has traveled to New York at least five times in three years to freshen her wardrobe with the latest from **Chanel**, Prada, and Louis Vuitton. The city's stores offer a better variety than what's available in Brazil, says Araujo, 39, who was shopping with her husband and two teen-aged daughters at Prada on Broadway.

Brazilians are helping support sales as Americans cut spending, says Chris Adams, chief executive officer of Sherry-Lehmann. "New York buyers are still the foundation of our business. But to see, in a down economy, a three- to fourfold increase from a market is just fantastic." The Brazilian who spent $100,000 at Stereo Exchange bought, among other items, a pair of $15,000 Bowers & Wilkins speakers, a $15,000 Runco projector, an $8,000 McIntosh Blu-ray disc player, and $7,500 in Kimber cables and power cords, says Wasserman. "We designed the system for him strictly through e-mail exchanges. He wired $50,000 to us and came up later to go through a complete demonstration." That's serious shopping. —*Iuri Dantas and Fabiola Moura*

The bottom line *Brazilian shoppers are boosting the fortunes of luxury retailers in New York. They're affluent and have a strong currency.*

Currencies

How the Swiss Curbed The Uber-Franc

▶ The central bank spent massively to keep the franc from skyrocketing

▶ "Interventions reached extreme dimensions"

The Swiss central bank may have saved its economy by embracing Chinese-style currency policy. Faced with a surge in the Swiss franc that threatened to derail growth, the Swiss National Bank has bought euros aggressively, quadrupling its foreign-exchange holdings since March 2009 to slow the currency's advance and protect exporters. By comparison the Chinese, who buy dollars partly to keep the yuan down, look conservative. China, holder of the world's largest currency stockpile, increased its reserves by a mere 28 percent in the same period.

In times of crisis, investors seek out assets known to preserve value, like gold or the Swiss franc. So as the collapse of Lehman Brothers Holdings in

Global Economics



Washers that explain what ails them page 23 ▶

September 2008 roiled investors, the franc began to rise. The danger was that a jump in the franc would throttle exports, which account for about half of Swiss gross domestic product. Then, with growth stalled, the Alpine economy would slide into deflation.

The Swiss central bank swung into action, buying euros while lowering interest rates to 0.25 percent from 2.75 percent in September 2008 to stimulate the economy and discourage foreign investors from buying Swiss bonds. The foreigners still piled in, and the Swiss franc rose 15 percent in the last 15 months through June, reaching a high of 1.30 francs to the euro on July 1. The central bank had a paper loss of $13 billion on its currency purchases in the first half. That's a big chunk of its $219 billion in foreign-exchange reserves.

Many economists say the Swiss came off surprisingly well. The franc's recent rise was a lot smaller than gold's 59 percent surge in the same period. Swiss manufacturers adjusted to the franc's strength while benefiting from low rates at home. Foreign sales at **Swatch Group** and **ABB**, the biggest builder of electricity grids, are rising, and manufacturing expanded at the fastest pace on record in July. In June, the Swiss National Bank raised its GDP growth forecast from 1.5 percent to about 2 percent, double what's projected for the euro region.

The Swiss National Bank can probably hold off from buying more foreign reserves for now. "Their policy was a success even if interventions reached extreme dimensions," says Frankfurt-based David Kohl, deputy chief economist at Julius Baer Holding, a 120-year-old Swiss private bank. "Ultimately, it didn't matter to them whether they suffered a loss."

The risk is that a further rise in the franc would force the Swiss to wade more deeply into currency markets, putting it on a "kamikaze mission," says Axel Merk, who oversees $500 million as president and chief investment officer at Merk Investments. "We'd rather have the SNB focus on sound monetary policy than a cat-and-mouse game with speculators they are bound to lose." For now, though, the Swiss have done a good job blunting the pain of the über-franc.
—*Simone Meier*

The bottom line *The Swiss central bank has bought foreign currency aggressively to keep the franc tethered to the ground.*

Labor

The Right to Strike May Be Coming to China

▶ **Talks in Guangdong could lead to radically overhauled labor laws**

▶ **"This has been a no-go area in China for decades"**

The name gives no hint of the revolutionary changes afoot for mainland workers. Yet the proposed Regulations on the Democratic Management of Enterprises, now being debated by the Guangdong Provincial People's Congress, could give Chinese labor the ultimate–and until now taboo–bargaining tool: an officially sanctioned right to strike. "This has been a no-go area in China for decades," says Robin Munro, deputy director at the Hong Kong-based China Labour Bulletin. All Chinese workers belong to one union, but it wields little power. "This is the first time ever Chinese authorities have said it is O.K. to strike."

The draft law could take effect by this fall in Guangdong, the industrialized coastal province where **Honda** workers in June illegally and successfully struck for higher wages. The proposed law is seen by many activists and researchers as a trial balloon before a possible national rollout. The rules: If one-fifth or more of a company's staff demands collective bargaining, then management must discuss workers' grievances. Before talks begin, the union must elect local worker representatives. Until now, union reps came from management ranks.

The next section of the proposed law ventures into even more radical territory. For six decades, picketing and disrupting production have been illegal and subject to harsh punishment. Under the Guangdong proposal, as long as workers first try negotiating and refrain from violence, they're allowed to strike.

Though the draft could still get watered down, the fact that officials are even considering legalizing strikes signals a sea change. The party's moves are an attempt to recognize–and regulate–what is already happening. "Every month there are hundreds of strikes," says Chang Kai, a labor relations professor at Renmin University of China who advised the Honda workers. "What the government is concerned about is whether it can control these strikes or not." Formalizing workers' rights could also advance China's goal of rebalancing

40,000

Estimated number of labor protests in China in 2008



the economy. "There is a new emphasis on how to reduce the wage gap and get consumers to spend more," says Chang-Hee Lee, an industrial relations expert at the International Labour Organization's Beijing office. "This is not very easy to accomplish unless workers have more bargaining power." *—Dexter Roberts*

The bottom line *A proposed law being debated in Guangdong could greatly strengthen the bargaining power of Chinese workers.*

CLOCKWISE FROM TOP: COURTESY KENMORE; ANDREW HARRER/BLOOMBERG; QILAI SHEN/BLOOMBERG; DATA: CHINA LABOUR BULLETIN

Debt Collectors

In Ireland, the Sheriff Is the Repo Man

- ▶ Sixteen of them collect debts and seize Jaguars and Mercedes
- ▶ "They love motor vehicles. ... They don't like dealing with cattle"

Where there's debt, there are debtors–and creditors. In Ireland there are also sheriffs. The Irish central bank says the economy will expand slightly this year after its worst recession in 89 years of independence. At the same time, the mountain of debt accumulated in what was once the euro region's most dynamic economy will take far longer to work through. The latest figure puts household debt at $182 billion, a staggering number for a country of 4.5 million people. Lending more than tripled in the decade through 2007, according to Goodbody Stockbrokers in Dublin.



Many Irish, buoyed by real estate wealth that has since evaporated, bought luxury cars, country estates, and other symbols of the good life. If they can't pay their debts, their cars and other goods are legitimate targets for Ireland's 16 sheriffs, self-employed agents appointed by the Justice Ministry to collect on unpaid taxes and delinquent loans.

Business is good. "We're getting orders worth millions," says John Fitzpatrick, a Dublin sheriff who has confiscated Jaguars, Range Rovers, and Mercedes from indebted businessmen. "Those people are owned body and soul by the banks," he says. In the High Court in Dublin, debt recovery claims rose 48 percent, to 5,653 cases in 2009, according to the Courts Service. Sheriffs chased down $922 million in unpaid taxes last year, up 3 percent.

Sheriffs are responsible for selling off the goods they seize, then paying the government or the banks. In an arrangement known as "poundage," the sheriffs are paid a percentage of the funds raised. Ricky Wilson at Wilsons Auctions outside Dublin says the amount of assets he has sold for sheriffs has increased by as much as 15 percent in 2010.

The Irish system predates the 12th century, according to Jim Stafford, who advises companies on what to do when the sheriff comes knocking. "When money was really tight, they literally used to take blankets off beds," says Stafford. "They don't do that anymore." Cars, he explains, are the preferred asset. "They love motor vehicles because they can be driven away," he says. "They don't like dealing with cattle." (Livestock are still very valuable in Ireland.)

They do have to deal with plenty of pain, though. "One home I visited was an absolute palace," says Fitzpatrick, a sheriff since 1979. "The guy was reduced to bankruptcy. He was emotional. I don't think he had anything left." Ⓑ *—Louisa Fahy*

The bottom line *Ireland is wading through billions in delinquent loans. Sheriffs help track down money to pay off the banks and the tax authorities.*

Tom Keene's EconoChat

Tom talks with former Labor Secretary **Robert Reich** about the jobs crisis.

How are we going to fix labor given the aftershock that we are in?
It used to be that when profits increased, jobs increased and often wages increased. That is no longer the case. Companies have done things that many of them had been reluctant to do before, and that is really intensively use the Internet and new technologies to outsource abroad and automate many of the jobs held by their U.S. workers.

Do we need a Thirties-like program? Or is the Reich prescription something more modern?
I think the answer is to extend the Bush tax cuts, certainly for everybody who is under $250,000. Secondly, maybe declare a two-year payroll-tax holiday on the first $20,000 of income, because 80 percent of Americans pay more in payroll taxes than they do in income taxes. Maybe thirdly, I would help out state and local governments. They are in terrible shape.

How would you grade the President's economic team?
To the extent that there is a problem, it's communication. I would not say the President or his economic team have done a superb job communicating why the stimulus works and, to the extent it did work, why it needs to be larger, how it can be larger, why we are facing a shortfall between the country's productive capacity and where we are in terms of demand. This is not rocket science. But I am afraid neither the President nor his economic team is able to do it as convincingly as some of the people on the other side are. Ⓑ



Keene hosts Bloomberg Surveillance *7-10 a.m., 1130AM in New York, XM 129, Sirius 130.*

92nd Street Y presents

Captains of Industry

Now in its 11th year, this series showcases interviews with some of the most dynamic and influential voices in business today.

Norman Pearlstine, moderator

Chief Content Officer of Bloomberg L.P. and
Chairman of Bloomberg Businessweek



in conversation with:



Arianna Huffington

Co-Founder and Editor-in-Chief, The Huffington Post
Tue, Sep 7, 8 pm, $29



Carol Bartz

CEO and President, Yahoo!
Tue, Dec 7, 8:15 pm, $29



Diane von Furstenberg

Founder of Diane von Furstenberg
President, Council of Fashion Designers of America
Thu, Jan 13, 8:15 pm, $29

This series is in partnership with Bloomberg Businessweek

92Y

Get Your Tickets Today!

Order online and save 50% on service fees at www.92Y.org/Businessweek or call 212.415.5500

Lexington Avenue at 92nd Street, NYC | An agency of UJA-Federation

Media Partner WNYC Hear It Now

Contents ▶ Developing-world deals for AIDS drugs 22 ▶ Appliances that can call for help 23 ▶ Small business lenders say they lack qualified borrowers 26
▶ The guessing game on BP's penalties 26 ▶ Company briefs 27 ● Edited by James E. Ellis



Shanghai showroom: Dealers are working harder to woo buyers

KEVIN LEE/BLOOMBERG

Inflation Forces Chinese Car Buyers Off the Road

▶ Shrinking purchasing power is slowing sales even as automakers increase production

▶ "We have to cut prices to keep business going"

China's appetite for cars has waned, and Zhu Dongwei, an auto salesman in the central Chinese city of Zhengzhou, is doing all he can to revive it. Customers at Zhu's **General Motors** dealership get a 14 percent discount, a sales tax refund, and a chance to win a free iPod if they buy a 41,800 yuan ($6,170) Matiz compact car. "This is our biggest promotion this year," Zhu said. "Without discounts, many people would wait, not buy."

Wholesale passenger-car deliveries in China grew in June at the slowest pace in 15 months, as rising prices reduced buyers' purchasing power. China's inflation rate that month stood at 2.9 percent, its second-highest level this year. Analysts say demand in the world's largest vehicle market may actually fall in the second half of this year. That would be the first decline in at least 17 months, and it could trigger a price war. "Some dealers and automakers may panic and offer the largest discounts they can," says Yale Zhang, a Shanghai-based analyst at consultant IHS Automotive. "If prices of daily necessities keep soaring, people's expectations of their future financial security will be undermined, reducing their desire to buy a car."

China's auto sales began slowing in April. Besides inflation, China's carmakers have been challenged by an increase in sales tax on small cars to 7.5 percent. It had been halved to 5 percent in 2009, and the cut had helped push up vehicle sales by 46 percent, to 13.6 million units last year, surpassing the U.S. for the first time.

The average price of China's locally made passenger cars fell by 2.08 percent in June from the year before, the biggest decline this year, according to the National Development & Reform Commission. Nonetheless, GM, **Volkswagen**, **Honda Motor**, and **Nissan Motor** are boosting capacity and introducing new models. Nissan, the largest Japanese carmaker in China by sales, aims to expand production by 68 percent, to 900,000 vehicles a year by

The SEC goes after the Wylys page 32 ▶



2012, with further increases later, Chief Executive Officer Carlos Ghosn said in April. The slowdown in sales growth since April "doesn't affect our plan," says spokeswoman Sharon Shen.

SAIC Motor, China's largest home-grown carmaker and a partner of GM and Volkswagen, said last month it plans to boost capacity by 47 percent, to 1.31 million vehicles annually, by 2012. Kevin Wale, group president of GM China, says the industry has reason to be optimistic. "We had an extraordinary rate of growth last year, so I think it's unfair to talk about a year-to-year negative [growth] rate," said Wale. "We expect the industry to grow at a stable pace through both this year and next year, and from a management perspective, we'll be monitoring inventory levels with our dealers, just to make sure that inventories don't get out of hand."

Still, the industry's expansion carries risk. Domestic auto output exceeded sales by 1.29 million vehicles in the first half of this year, according to the China Automotive Technology & Research Center. The average stockpile period, a measure of the time between when a car is manufactured and its registration, was 55 days in June, compared with 41 days in February, the center says. "Automakers should reduce supply rather than getting into a price war," says Zhao Hang, president of the center.

Such concerns mark a change from early this year, when some customers in Beijing paid a premium of almost $3,000 to skip ahead of a waiting list for **Toyota Motor**'s RAV4 SUVs, according to Wu Bin, a salesman with Beijing Guangshun Toyota Sales. The dealership stopped charging the premium and cut the vehicle's price in March when sales declined amid global recalls of Toyota models. It is now offering a discount of about $700. "We have to cut prices to keep business going," says Wu. *—Tian Ying and Ying Diao, with Jin Jing*

The bottom line *Demand in China's auto market is cooling even as output is increasing. That has caused dealers to cut prices and offer incentives.*

5.3

MILLION

Number of viewers who watched the Season 2 premiere of MTV's *Jersey Shore* on July 29, making it the No. 1 cable telecast of 2010 among viewers aged 12-34. It was the highest viewership of any Viacom series premier since 2002

Pharmaceuticals

Why AIDS Drugs Now Flow to the Third World

▶ **Some producers of the life-saving medicines are licensing them gratis**

▶ **"We're talking about the how rather than ... whether" patents get shared**

Salim Abdool Karim received a standing ovation at the International AIDS Conference in Vienna last month when the South African doctor announced that a vaginal gel reduced the risk of sexual transmission of HIV to women by more than half. The advance was hailed as a breakthrough for the world's poor.

The successful development of the first protective agent against the virus after years of failures wouldn't have been possible without the cooperation of Foster City (Calif.)-based **Gilead Sciences**, the leading producer of some of the world's priciest AIDS medicines. Gilead, which logged almost $6 billion in AIDS-drugs sales last year, donated the gel's key ingredient, sold in the U.S. as a pill called Viread, and granted a royalty-free license to Conrad, a nonprofit reproductive-health organization that plans to distribute the product in Africa.

Pharmaceutical companies, once blasted as uncaring or downright greedy for charging thousands of dollars for a year's worth of AIDS medicines like Viread in poor countries, lately have been slashing prices and licensing their drugs for free or nominal cost to nonprofits or local manufacturers in the developing world. Activists say the largesse is in part an attempt to avoid a repeat of the public-relations backlash the companies received a decade ago after initially pricing the drugs at levels only patients in the West could widely afford.

Also, a network of aid agencies and local manufacturers is now in place to handle production and distribution of the compounds—something many Western companies don't want to handle themselves because of the cost and transportation hassles. "It's a pretty remarkable" shift, says Mitchell Warren, a New York AIDS activist, noting that 10 years ago drugmakers argued that the infected in Africa couldn't be trusted to properly take complicated drug regimes at any price. Two years ago, **Pfizer** granted a free license to a nonprofit group to develop the company's AIDS drug, Selzentry, for use in another experimental gel. Last month a **GlaxoSmithKline** affiliate said it will give away licenses to some of the AIDS drugs it's developing in 60 of the world's least-developed nations where 80 percent of people with HIV live.

At the AIDS meeting in Vienna, Unitaid, another nonprofit, said it is discussing the creation of a "patent pool" with Gilead, **Merck**, and **Johnson & Johnson** to license drugs in development to generic makers who could sell medicines at lower prices than possible for the large companies. "We're talking about the how rather than the whether" companies will participate, said Ellen 't Hoen, Unitaid's executive director.

Makers of AIDS drugs have been under pressure to increase access in the Third World since an international AIDS meeting held in Durban, South Africa, in 2000. Two years later former President George W. Bush committed to providing antiretroviral drugs for 2 million HIV-infected people in Africa and the Caribbean as part of his $15 billion AIDS initiative, creating a potentially profitable market for low-cost manufacturers. By 2005, Bill Clinton's foundation brokered discounts from generic manufacturers in India that have reduced the cost of combination drug treatments, which can reach thousands of dollars per year in the West, to as low as $120 a year per patient. As prices fell, demand

THIS PAGE: MICHAEL FAAS PHOTOGRAPHY. OPPOSITE PAGE, FROM TOP: PAOLO PELLEGRIN/MAGNUM PHOTOS; TOM GRILL/GETTY IMAGES; COURTESY KENMORE; DANIEL ACKER/BLOOMBERG



increased, yielding economies of scale that have helped lower prices further, says Michael Kazatchkine, executive director of the Global Fund to Fight HIV/AIDS, Tuberculosis and Malaria.

By licensing the drugs to be manufactured by third parties in developing countries, big pharmaceutical makers get positive publicity for helping the poor without being forced to distribute the drugs at a big discount to what they sell them for in richer nations. The lower-priced pills are required to be sold in distinctly different shapes, sizes, or colors, dramatically lowering the possibility they'll end up back in the U.S. or Europe through black market channels to compete against full-price medicines. —*Simeon Bennett and Tom Randall*

The bottom line *By licensing AIDS drugs at little cost for use in the Third World, drugmakers get favorable press and don't bear distribution costs.*

Quoted

"If you have to create a new company in an old industry, you want to reexamine what people have taken for granted. Why would you want to inherit the mistakes of the past?"

—Elon Musk, chairman of Tesla Motors, on why he didn't adopt Detroit's business model to make and market his new Model S electric-powered car



Customer Service

The Washers and Dryers that Talk Back

▶ New appliances describe their service problems over the phone

▶ A repairman "didn't know what was wrong, but he knew what wasn't"

Last February, Mel Bonner, 63, of Tinley Park, Ill., noticed water beneath his washing machine. He couldn't find a leak, so he dialed the manufacturer's customer service number. Then he held the receiver up and let the machine do the "talking."

The washer was "beeping, and lights [were] flashing" as it transmitted self-diagnostic data, says Bonner, a retired electrician. When the telephone representative couldn't figure out the problem, a technician was dispatched to Bonner's home. The technician "didn't know what was wrong" when he arrived, says Bonner, "but he knew what wasn't wrong." The washing machine was working properly again in less than half an hour. "It was just so simple," says Bonner. "I don't know why everybody doesn't have this."

On Aug. 4, Kenmore, the appliance brand of **Sears Holdings**, announced Kenmore Connect, a technology developed with **LG Electronics** and intended to speed up appliance repairs. Bonner was one of several thousand customers in a pilot program to test the remote-servicing technology. Company representatives review screens of data generated by ailing Kenmore machines and transmitted via a toll-free phone line. Next week, LG will add the feature to many of its top-of-the-line laundry appliances in the U.S.

Most of the calls Kenmore representatives receive during a customer's first year of ownership can be handled over the phone, says brand Vice-President Betsy Owens. Even when a repair visit is unavoidable, the time the technician spends making adjustments or replacing parts will be reduced, company officials say. Consumers won't pay more for the technology, which will come with appliances priced from $799 to $1,499.

Miele, based in Gütersloh, Germany, has offered a similar remote technology in some of its high-end appliances since 2008. LG already uses it in some of its products sold in Korea. The Kenmore announcement marks the spread of the service option to a much wider market.

Kenmore Connect may yield savings for the company, even though that wasn't the main goal, according to Owens. The company maintains the nation's largest repair fleet—more than 10,000 trucks—and handles 12 million service calls annually. The new technology may encourage more customers to pick up the phone to report minor problems, but it is expected to result in fewer in-person service visits. Owens estimates that Kenmore eventually could reduce its truck runs by half.



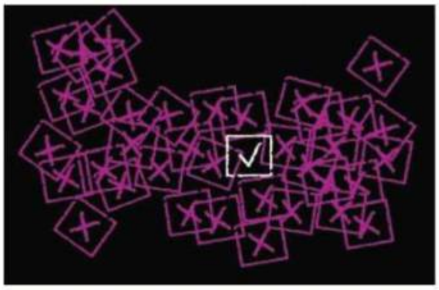
Kenmore Connect is expected to cut down on repairman visits

"Almost 60 percent of the time that we send a truck out, there's no part that is put into that machine; there is no mechanical failure," says Tim Adkisson, a product engineer for Kenmore. Now the washers will be able to speak up for themselves and suggest minor adjustments. —*Chris Prentice*

The bottom line *New technology allows washers and dryers to diagnose their problems and tell a telephone representative.*

Enterprise

The Lending Squeeze On Small Business



▶ Banks say they can't find enough qualified borrowers to meet goals

▶ Lines of credit are being used "at the lowest level I've ever seen"

Brad Sterl didn't think getting a $1 million line of credit from a bank would be difficult after his pizza crust manufacturing company in Pittsfield, N.H., returned to profitability in 2009. **Rustic Crust**, founded in 1996, had been doubling sales each year since 2005 when it raised venture capital. It hadn't booked a profit because it was investing in expansion. With sales topping $10 million annually and $1 million in cash in the bank, Sterl wanted the credit line as a cushion. Last fall he met with loan officers at three lenders, including **Bank of America**, who each told the 44-year-old he would not qualify. "They wanted to see multiple years of profits," he says. Rustic Crust eventually secured a credit line, at a higher cost, through the nonprofit **New Hampshire Community Loan Fund**.

Under pressure from Washington last year, Bank of America, **Wells Fargo**, **JPMorgan Chase**, and **Huntington National Bank** announced they would boost their small business lending in 2010 and set specific targets. Taken together, their pledges represent potentially more than $12 billion in new credit to small and midsize companies. At the current pace it looks as if only Bank of America is on track to meet its goal. Bankers at BofA and others say that while they hope to hit their targets, many small companies seeking loans aren't creditworthy, and those that are don't want loans right now.

Bank data show that small businesses, which normally seek loans of less than $1 million, are still having trouble getting credit. For small companies, total outstanding credit dropped to $663 billion in the first quarter of 2010 from nearly $700 billion in mid-2008, according to quarterly regulatory filings. The share of business owners who say they cannot get adequate financing rose to 41 percent, according to a National Small Business Assn. (NSBA) survey released in July, up from 39 percent in December and 22 percent two years ago.

Some would-be borrowers appear to have become riskier through no fault of their own, says NSBA President Todd McCracken. During the financial crunch, for example, banks lowered existing credit lines of many small busi-

ILLUSTRATION BY TOPOS GRAPHICS



ness customers, which in turn lowered their credit scores because they were left using a higher percentage of their available credit, he says. Some also have watched the value of their real estate and other assets plummet, reducing the amount they can use for collateral.

Many companies that once gorged themselves on easy credit now lack the cash flow to support the debt, says Marc Bernstein, head of Wells Fargo's small business division. Too much existing debt is the top reason Wells Fargo declines would-be borrowers, he says. The bank aims to boost new small business lending by 23 percent this year, to $16 billion. Through the first half, Wells Fargo originated $6.6 billion in new credit to companies with less than $20 million in annual revenues. According to Bernstein, demand for loans is down among healthy borrowers. "Small businesses that have lines of credit are using those lines at the lowest level I've ever seen," he says.

Bernstein's counterpart at Bank of America reports the same situation. "If you look at the profile of the businesses that are best positioned to take on new credit, those would be companies that are larger in revenue. But those are also the ones that may have more cash and say, 'You know what, we're going to wait,'" says Robb Hilson, BofA's top small business executive. He says his bank is on track to exceed its goal of increasing lending to small and medium-sized businesses by $5 billion this year, to $86.4 billion. That includes new lending and renewals of existing credit lines. BofA's loan data show most of the $45 billion in loans the bank made in the first half of 2010 went to companies with $20 million to $50 million in revenue. Lending to smaller companies in the first half was essentially flat compared with 2009.

BILLION

The goal set by four major banks to boost small business credit in 2010

Other banks have increased lending from the low 2009 levels. Chase originated $4.5 billion in new credit to companies with less than $20 million in revenue in the first half of 2010, up 37 percent from the same period last year and nearly halfway toward the bank's goal of $10 billion, says spokesman Tom Kelly. Huntington National Bank, a Columbus (Ohio) regional lender, loaned $451 million to companies with less than $15 million in revenue in the first half, said CEO Stephen D. Steinour in a statement. Huntington aims to lend $1.2 billion to such businesses in 2010 as part of a three-year expansion of small business lending.

The more sluggish than expected recovery also has made the banks' lending target harder to reach. Says BofA's Hilson: "It's a very aggressive goal given the challenging economic environment." —*John Tozzi*

The bottom line *Four banks pledged to increase lending to small businesses in 2010. Finding qualified applicants, they say, hasn't been easy.*

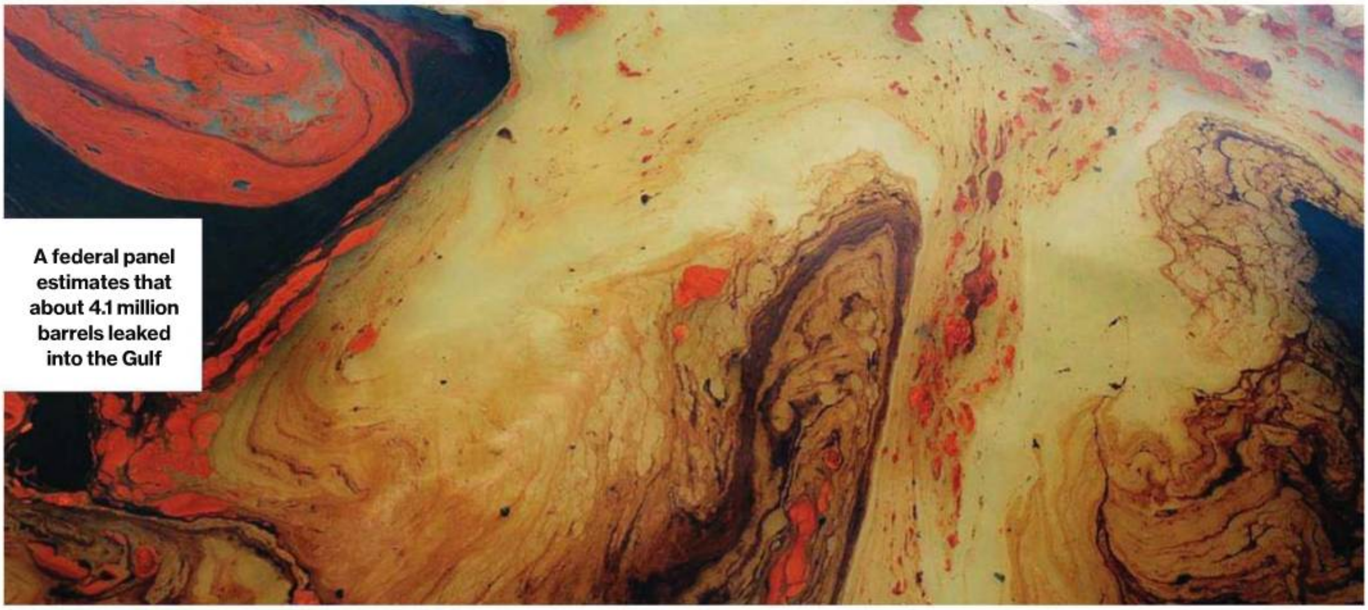
Booming is
helping build a deserving family a home. Financed by hundreds of claw hammers and tons of roofing nails.

For Ahmed Mady, owner of Paragon Remodeling, Booming is being successful by giving back. Ahmed started purchasing things like sheet rock and 2x4s with his American Express OPEN Gold Card, eventually netting him almost half a million Membership Rewards® points. He then turned those points into more building supplies. Which he donated to help build a new home for the 14-member Jackson family. Get your business Booming at open.com.

AHMED MADY
PARAGON REMODELING
PARAGONREMODELING.COM
MEMBER SINCE 05

Start Booming.
AMERICAN EXPRESS OPEN
open.com

©2010 American Express Company. All rights reserved. Enrollment in Membership Rewards required. Other terms, conditions and restrictions apply. Visit open.com/gold for details.



A federal panel estimates that about 4.1 million barrels leaked into the Gulf

Energy

The Oil Spill Ends. Now Come the Fines

▶ BP faces almost $18 billion in civil fines if gross negligence is proved

▶ "The federal government doesn't want to push BP into insolvency"

After months of technical setbacks, embattled **BP** in early August was finally on the verge of capping its runaway Macondo well, source of the largest oil spill in U.S. history. Even as the oil giant's focus shifts toward the massive cleanup of the Gulf of Mexico, it now must contend with expensive civil fines it faces stemming from the disaster.

BP could face as much as $17.6 billion in civil penalties, based on a federal panel of experts' estimate on Aug. 2 that about 4.1 million barrels of oil leaked from its well into the Gulf. Although environmental lawyers say BP is likely to negotiate a lower penalty, the fines could still crimp the company's ability to pay for cleanup costs, force it to sell more assets, and cut into future investment plans of incoming Chief Executive Officer Robert Dudley.

The Clean Water Act makes BP, as owner of the oil, liable for fines of $1,100 per barrel spilled even if it did nothing wrong, says Wayne State University law professor Noah Hall in Detroit. The penalty jumps to $4,300 per barrel if BP was grossly negligent. Hall says gross negligence in a civil case would include making "conscious decisions" that increased the likelihood of an incident while engaged in a risky business, such as deepwater drilling.

BP Chairman Carl-Henric Svanberg told Bloomberg Television on July 27 that the company doesn't believe it will be found grossly negligent or determined to be the sole responsible party for the spill.

Hall says the fine ultimately imposed is not likely to be "anything like that" $17.6 billion maximum because BP and the government have a mutual interest in a lower number. "Both the federal government and any judge will take into account that BP has spent or will spend billions to remediate and clean up the spill," he says. "At some point, BP says: 'If you hit us with the maximum in penalties, plus $20 billion in cleanup and $20 billion in claims, you'll push us into bankruptcy.' The federal government doesn't want to push BP into insolvency."

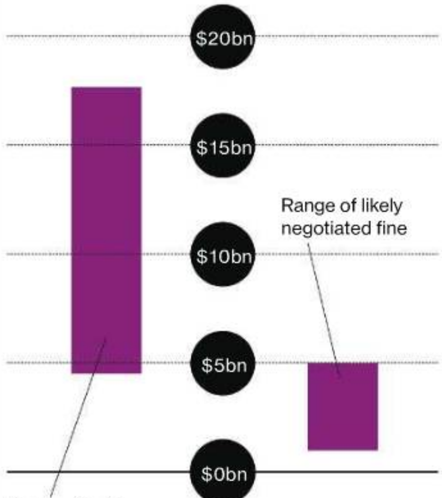
The civil fines under U.S. environmental laws are separate from costs BP is facing to clean up the spill and compensate victims of the disaster. Last month, BP took a $32.2 billion charge for the cost of cleanup and compensation, and its estimate of possible penalties. The company has already paid more than $4 billion in spill-related expenses.

BP has established a $20 billion escrow fund to pay remaining claims by individuals and businesses harmed by the spill. For those who don't take an escrow payout, claims will be handled in more than 300 proposed class actions and shareholder suits tied to the spill. The company may also be liable for civil penalties for violations of other environmental laws, including the Endangered Species Act. That law imposes fines of as much as $25,000 per animal killed by the oil, a number not yet estimated.

The U.S. Justice Dept. is investigating whether criminal or civil laws were broken before the explosion, Attorney General Eric Holder said in June. The government could pursue fines under civil and criminal laws, as it did when it

For BP, a civil penalty guessing game

Legal experts say BP may be able to negotiate a total civil fine of $1 billion to $5 billion, down from a maximum of $17.6 billion the company now faces based on the volume of oil spilled.



THIS PAGE: SPENCER PLATT/GETTY IMAGES. OPPOSITE PAGE, FROM TOP: SARA KRULWICH/THE NEW YORK TIMES/REDUX; ARNO BURGI/DPA/LANDOV; MIKE THEILER/REUTERS

claimed BP released more than 5,000 barrels in two spills from its Prudhoe Bay (Alaska) field in 2006. Gregory Evans, a Los Angeles attorney who represents defendants in environmental litigation, says BP likely can mitigate the fines from the Deepwater Horizon incident by cooperating with investigators probing the causes of the blast and size of the spill.

Evans says that the Macondo spill estimate from the government's scientific panel is likely only "a starting point" for negotiations between BP and the government. "It does not preclude BP or any of the other potentially responsible parties from challenging it ... with reliable, independent studies," he says. Indeed, BP spokesman Daren Beaudo cautioned after the panel's finding that "there will always be uncertainty in any estimate as the flow cannot be measured directly."

The big worry for BP is avoiding a gross negligence finding by a court. Besides triggering the $4,300 per-barrel maximum fine, such a ruling would also bar BP from seeking contributions from its well partners, **Anadarko Petroleum** and a unit of Japan's **Mitsui Oil Exploration**. Both have already shown reluctance to pay portions of the mounting cleanup costs. "Gross negligence protects the silent partners," Hall says. Some lawyers believe BP's need to keep its partners on the hook to share in any potential fines increases the government's leverage in negotiations with the company. "You don't have to be that bad to meet the standard of gross negligence" under civil law, Hall says. It's only necessary to show "that they engaged in risky business and made some bad decisions."

Houston attorney David H. Berg, who often sues polluters on behalf of municipalities, says "there's zero chance" the U.S. will impose the maximum civil fine on BP. Berg figures BP should expect to pay fines of $3 billion to $5 billion because it has a record of environmental compliance problems, including previous settlements in the Alaska incident and another in Texas. Hall, however, predicts the civil fines on BP would be lower, only about $1 billion to $2 billion. "That would [still] allow Obama and the Interior Dept. to say they forced the largest fine ever," he says. —*Margaret Cronin Fisk and Laurel Brubaker Calkins*

***The bottom line** BP, which faces a $17.6 billion maximum civil fine for the Gulf spill, is likely to negotiate a far lower penalty.*

In brief

by David Rocks



Barnes & Noble's investment in the Nook e-book may produce a loss this year

Barnes & Noble
After Booking Losses, A Bookseller on Sale
Yielding to pressure from investors as a shift to digital books hits the bottom line, the biggest U.S. bookstore chain has put itself on the block. In May billionaire Ron Burkle, who owns 19 percent of Barnes & Noble, launched a lawsuit seeking to invalidate the bookseller's "poison pill" defense against takeovers to boost the value of his holding; the sale could give him what he wants. Chairman Leonard Riggio, B&N's biggest shareholder, says he may join with a group that will bid for the company. In June the chain forecast a possible loss of 40¢ a share for the current fiscal year due to a $140 million investment in its digital book unit.



Research in Motion
Too Secure for Saudi Snoops
Saudi Arabia has ordered the suspension of BlackBerry's instant-message service because officials can't monitor the traffic on RIM's encrypted network. Saudi phone companies and RIM are in talks over the ban, which is scheduled to begin on Aug. 6. RIM faces mounting challenges as some developing countries tighten restrictions on mobile communications. The United Arab Emirates, India, and Indonesia have also threatened to suspend BlackBerry services. The controversy coincides with the debut of BlackBerry's touchscreen Torch, meant to compete with Apple's iPhone.

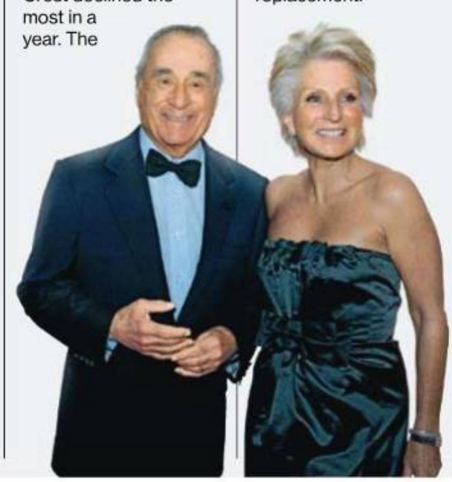
Google
Trademarked Ad Words? No Problem
Google said on Aug. 4 it will let European advertisers buy search-ad terms even if they are another company's trademark. The decision stems from a European court ruling in March that freed Google from liability over the sale of trademarked search terms. It's a setback for luxury-goods makers and others who hoped to prevent rivals and counterfeiters from grabbing their customers on search engines.

Mexicana
Bankruptcy for Mexico's Top Airline
Compañía Mexicana de Aviación, Mexico's biggest airline by passengers, has filed for protection from creditors in Mexico and the U.S. after executives said they had failed to reach cost-saving agreements with unions. The U.S. filing lists more than $500 million in assets and $1 billion in debt. The carrier blames losses on a rise in jet fuel prices, a 2009 flu epidemic that hurt Mexican tourism, and the global recession. The push to cut pay comes as low-cost competitors Volaris and Interjet eat into Mexicana's business. The 87-year-old company said the bankruptcy won't affect operations. Mexicana's low-cost affiliates, Click and Link, weren't included in the filing.

Procter & Gamble
A Potential Profit Washout
P&G's first-quarter forecast fell short of analysts' projections as financially strapped consumers turn away from name brands. On Aug. 3 shares at the maker of Tide and Crest declined the most in a year. The household-products giant is boosting spending on promotions and new products.

Genzyme
France's Sanofi Is On the Hunt
Genzyme, the world's largest maker of medicines for genetic diseases, may be acquired by Paris-based Sanofi-Aventis, according to two people with knowledge of the matter. Sanofi is interested in buying Genzyme to help replace revenue it will lose as its drugs face competition from generics. Sanofi is offering $67 to $70 per share, while Genzyme shareholders want $80.

Washington Post
***Newsweek* Sold to an Audio Kingpin**
Sidney Harman, founder of audio-equipment maker Harman International and husband of U.S. Representative Jane Harman (D-Calif.), has agreed to buy *Newsweek* from Washington Post Co., ending a three-month bidding process. The terms of the deal weren't disclosed. Since 2007, *Newsweek* has lost $44 million. Harman, 91, agreed to keep most of the magazine's 300-plus employees, while Post Co. will assume severance costs for any *Newsweek* employees who are dismissed. *Newsweek*'s editor, Jon Meacham, announced that he would leave once the deal is complete. Harman says he is searching for a replacement.



Contents ▶ Does Obama deserve his Detroit victory lap? 30 ▶ Insurance practices come under fire 31 ▶ Target's campaign finance cautionary tale 32 ▶ The SEC sues the Wyly brothers 32 ▶ Rangel holds up the Ways & Means tradition 32 ● Edited by Paula Dwyer

Politics&Policy

Obama: Venture Capitalist-in-Chief

▶ The U.S. gambles big on electric cars and batteries

▶ "What determines success is ... the capacity to let the losers go"

Racks of lime-green batteries awaited inspection on the factory floor when the well-connected investor swept through **Smith Electric Vehicles** in Kansas City, Mo., last month. A week later he broke ground on an advanced vehicle battery plant in Holland, Mich., the ninth battery facility his money has helped jump-start in the last year.

Meet the country's venture capitalist-in-chief, President Barack Obama. By the end of 2011, the White House plans to channel more than $50 billion to thousands of clean-technology companies through tax credits, low-interest guaranteed loans, and grants. Add in money for a "smart grid," research, and consumer tax breaks, such as the $7,500 credit for buying an electric car, and the commitment rises to $69 billion.

Obscured by the epic political battles over health care and financial regulation, Obama has turned the government into the chief financier of a manufacturing base for clean-energy technology. He envisions thriving new industries putting Americans to work churning out green products such as high-performance batteries, electric cars, low-energy lights, super-efficient air conditioners, wind turbines, and solar panels.

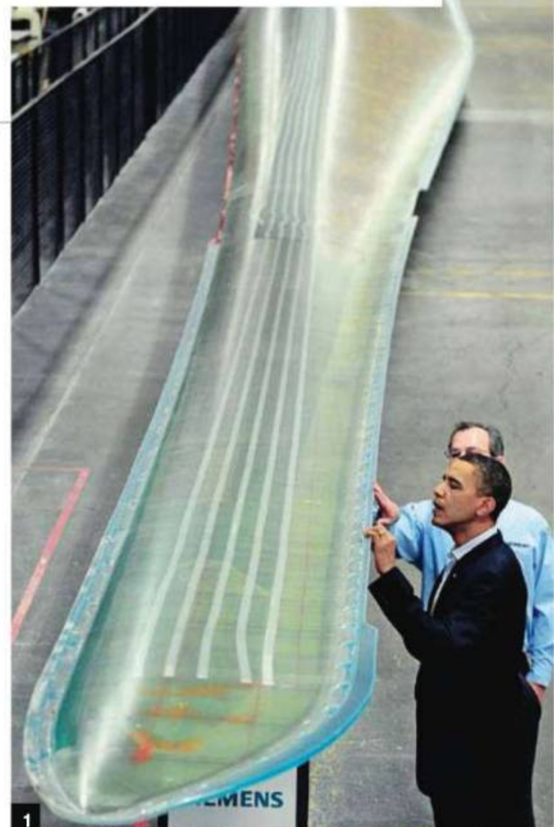
That level of government intervention in a selected business sector adds up to a new American industrial policy—and it's stirring a heated debate among economists and academics. The Administration's clean energy assistance is "undoubtedly one of the larger efforts" to create an industrial policy in U.S. history, says Harvard Business School Professor Josh Lerner. A skeptic, Lerner wrote *Boulevard of Broken Dreams*, an examination of decades of government efforts to spur the growth of chosen industries.

Obama has turned the government into the chief financier of a new cleantech manufacturing base

Obama's biggest gamble is on electric cars and related components, on which the U.S. is spending more than $5 billion. In auto batteries alone, the White House says that it will take the country from two factories producing 2 percent of the 2009 global output of high-performance batteries to 30 factories accounting for 20 percent of the world's output by 2012. Much of the focus is on producing lithium-ion batteries, found in many laptops, that will power autos and yet be lighter in weight and hold more charge than existing models.

The country has been down this road before. During the oil shocks of the 1970s, President Jimmy Carter created the public-private **Synthetic Fuels Corp.**, which was supposed to free the country from OPEC dependence by nurturing an industry producing synthetic oil and natural gas from domestic shale and coal. When oil prices collapsed, so did the enterprise's business plan, at a cost to taxpayers that an Energy Dept. study put at $4 billion in 2005 dollars. Adventures in industrial policy by governments around the world have squandered tens of billions of dollars chasing fashionable but ill-conceived ideas. In 1981, for example, the French government tried to shore up its electronics industry by acquiring a number of lumbering corporate giants and pressuring smaller companies into mergers. The effort choked off innovation by smaller companies and led to large losses, Harvard's Lerner says.

Still, the U.S. has successfully nudged along many emerging industries throughout its history, including railroads that were built in the 19th century with government



















The President reviews his portfolio 1. **At Siemens Energy in Iowa** 2. **Visiting a Chevy Volt assembly plant** 3. **At Smith Electric Vehicles in Missouri** 4. **Addressing Chrysler workers in Detroit** 5. **With Smith's trucks** 6. **His signature on the hood of a new Jeep** 7. **Touring an MIT alternative energy lab** 8. **At the DeSoto Next Generation Energy Center in Florida** 9. **Visiting lithium-ion battery maker Celgard in North Carolina**

A worker at GM's Hamtramck (Mich.) assembly facility, one of the carmaker's nine plants that skipped the traditional summer shutdown

The Auto Industry

Did Obama Save Detroit?

President Barack Obama has been touring auto plants, visiting General Motors and Chrysler on July 30, a little more than a year after they emerged from bankruptcy; he is set to visit a Ford plant on Aug. 5. The President made the case that his Administration's $59 billion bailout and the forced restructuring of the companies helped save autoworkers' jobs and the U.S. manufacturing base. While Ford did not take federal funds, it has acknowledged that the rescue indirectly helped it. Republicans and many voters say the bailout was misguided. Democrats and their labor union allies say the rescue was a success. Here are the White House's claims, and the arguments both ways. —*Jeff Green and David Welch*

THE ADMINISTRATION SAYS

There are growing signs of revival in the auto industry, as companies reopen plants, add shifts, and hire workers

AGREE Auto industry employment has increased by 55,000 in the year ended in June, the fastest rate since 1999. Nine of GM's 11 manufacturing and assembly plants skipped the traditional summer shutdown. The Chrysler plant that makes the 2011 Jeep Grand Cherokee also stayed open. One Chrysler and four GM facilities have added shifts.

DISAGREE The new jobs help, but not much. Carmakers shed 334,000 jobs in the year before the bankruptcies. Total employment is now 573,500, vs. 921,700 in 1978. Some of the rescue funds are bolstering operations overseas, which doesn't add U.S. jobs. Chrysler is getting engineering know-how from Fiat, also limiting the number of new American white-collar jobs.

THE ADMINISTRATION SAYS

The companies are globally competitive again

AGREE Exports of cars and parts from January to May 2010 increased 57 percent from the same period in 2009. Sales to China were up 283 percent for a total of $1.85 billion.

DISAGREE Even with that growth, U.S. auto and parts makers have a $43 billion trade deficit with the rest of the world. U.S. exports of passenger vehicles and parts rose 63 percent during the January to May period, while imports from other countries rose 66 percent, according to the American Automotive Policy Council.

THE ADMINISTRATION SAYS

The companies are returning to profitability

AGREE All three had profitable first quarters, and Ford had a profitable second quarter.

DISAGREE Auto sales this year are on track to be 11.3 million, the lowest since 1982, with the exception of last year's 10.4 million. Annual sales averaged 16.8 million vehicles from 2000 through 2007. The big question is whether the companies can generate enough profit to improve cars and compete globally.

loan guarantees and land grants. The jet engine and semiconductor industries received government seed money, as did the Internet. "You will not find an advanced economy on this planet that has not undertaken to help a private industry overcome market barriers," says Jared Bernstein, chief economist for Vice-President Joe Biden. China may spend $738 billion over the next decade to develop cleaner energy, Jiang Bing, of China's National Energy Administration, said last month.

Most economists agree that government support works best when it's limited to a risky early stage of development. The financial crisis caused private capital to retreat from clean energy just as Obama was hoping to ramp it up. After the government started committing funds, private money moved back in, with a record $2.1 billion in U.S. clean energy venture deals in the second quarter, according to Bloomberg New Energy Finance.

Will consumers buy any of this? Electric cars, typically smaller and more expensive than gasoline-powered autos, could be a hard sell. With the debate over caps on carbon emissions unresolved, the economics for many clean energy businesses are more uncertain than ever. "If the policy is going to have any effect, it also has to address the other side of this: How are you going to create a demand for these products?" says James Manyika, director of the McKinsey Global Institute.

The biggest knock against industrial policy is the prospect of bureaucrats and politicians picking winners and losers. The torrent of U.S. clean-energy money has allowed Obama to attend high-profile events in recession-weary Midwestern states likely to be 2012 battlegrounds. Auto analyst David E. Cole says favoritism does not appear to have been a factor in award decisions on technologies such as advanced batteries. "These companies have the right organizations to accelerate the development of the technology," says Cole, chairman of the nonprofit Center for Automotive Research. Still, he questions using federal money to assemble electric vehicles, which he says diverts funds from research that could lead to technology breakthroughs. The Administration says grants and loans are vetted and ranked by independent

PREVIOUS SPREAD, CLOCKWISE FROM TOP LEFT: JEWEL SAMAD/AFP/GETTY IMAGES; SAUL LOEB/AFP/GETTY IMAGES; DETROIT FREE PRESS/MCT/LANDOV; LARRY W. SMITH/EPA/LANDOV; DOUG MILLS/THE NEW YORK TIMES/REDUX;



THE ADMINISTRATION SAYS

Prospects are increasing that taxpayers will get back the $85 billion spent to rescue GM and Chrysler

AGREE GM repaid a $6.7 billion loan five years early. The U.S. still has almost 61 percent of the common stock, and when GM makes an initial public offering this year, most of the proceeds will go to taxpayers. Chrysler Financial, the lending arm of Chrysler, repaid $1.9 billion to taxpapers. A program supporting parts suppliers will wrap up soon, and taxpayers will be repaid.

DISAGREE Only $13 billion of the $85 billion in total rescue funds has been repaid. Of that, a $6.7 billion loan to GM was repaid with government funds, meaning taxpayers were paying themselves back. The market would have to value GM at $80 billion for taxpayers to break even on that investment.

experts to insulate awards from political pressure.

That could be tested in coming years when pressure builds to extend money to struggling companies that a cold-hearted capitalist would pull the plug on. When the stimulus funds run out, will the White House cut off companies that don't make the grade and turn its back on well-connected donors and factories the President has personally promoted? Says Kennedy School of Government Professor Dani Rodrik: "What determines success in industrial policy is not the ability to pick winners but the capacity to let the losers go." *—Mike Dorning*

The bottom line *Economists and academics disagree over whether Obama's $69 billion investment in clean technology is smart industrial policy.*

PETE SOUZA/THE WHITE HOUSE; TODD SUMLIN/GETTY IMAGES; BRIAN BLANCO/EPA/ZUMA PRESS; PABLO MARTINEZ MONSIVAIS/AP PHOTO. THIS PAGE, FROM TOP: REBECCA COOK/REUTERS; BILL CRAMER/WONDERFUL MACHINE

Insurance

Turning a Profit on Soldiers' Death Benefits

▶ Major insurers hold back billions of dollars, paying only modest interest

▶ "It's disgraceful on the part of the insurance companies"

Why are large life insurance companies profiting from billions of dollars they hold on behalf of the families of fallen military service members? *Bloomberg Markets* magazine senior writer David Evans posed that question in an article in its September issue. The article, which took a close look at practices at **Prudential Financial**, has sparked sharp criticism from Cabinet members, reform proposals from U.S. lawmakers, and a fraud investigation by the New York Attorney General. The U.S. Veterans Affairs Dept. and the National Association of Insurance Commissioners say they are reviewing military life insurance arrangements.

"It's disgraceful on the part of insurance companies," Senator John McCain (R-Ariz.), a onetime prisoner-of-war in Vietnam, said in an interview on Bloomberg Television. "We'll obviously have to be looking into it."

Under scrutiny are so-called retained-asset accounts. More than 100 carriers use the accounts to earn income on $28 billion owed to beneficiaries. New York-based **MetLife**, the biggest U.S. life insurer, retains about $10 billion and was among the carriers subpoenaed by Andrew Cuomo, the New York Attorney General.

Many life insurance companies suggest to beneficiaries that as an alternative to taking a lump-sum payment of death benefits, they leave the bulk of the policy proceeds with the carriers. The accounts were set up for beneficiaries such as Cindy Lohman of Great Mills, Md.; her 24-year-old son had been killed by a bomb in Afghanistan. Prudential and the other insurers give the recipients limited checkbook-like access to the funds and pay modest interest. Meanwhile, the carriers can invest the money, obtaining a far higher return than what they offer to beneficiaries. Families often receive misleading guarantees about the safety of the accounts, which are held in corporate coffers, not in federally insured banks, *Bloomberg Markets* found.

A half-dozen members of President Barack Obama's Cabinet sit on an advisory council overseeing life insurance for military service-members. The last time the council met, in November, none of the Cabinet members attended the annual meeting. Aides accustomed to handling the issue for their agencies go as representatives. "The advisory council gets briefed on what's going on, how much money is going out, how many death benefits," says John Gingrich, chief of staff for Veterans Affairs Secretary Eric Shinseki. Now, Shinseki and other Cabinet members have joined a growing number of lawmakers calling for an overhaul of insurer practices. Representative Debbie Halvorson (D-Ill.), has proposed a measure to set new rules for insurance companies that profit from accounts held



Lohman with a photo of her son Ryan, who was killed in Afghanistan

The man who makes Bing's must-haves page 39 ▶



for dead soldiers and veterans. Prudential, based in Newark, N.J., defended retained-asset accounts as helpful to survivors, especially the loved ones of soldiers. "For some families, the account is the difference between earning interest on a large amount of money and letting it sit idle," company spokesman Bob DeFillippo told Bloomberg. Prudential follows the law, he added. MetLife spokesman Joseph Madden says his company similarly adheres to legal requirements. Its customers appreciate its version of retained-asset accounts, Madden adds. Beneficiaries get "peace of mind and time to make an informed decision while earning interest in the interim."

—*Tony Capaccio and Patrick O'Connor*

The bottom line *Congress and the Administration are calling for an overhaul of life insurers' military death benefit practices.*

Campaign Finance

Target's Off-Target Campaign Contribution

- ▶ **Some gay-rights activists are calling for a boycott of the retailer**
- ▶ **"There's still a market out there for reputation"**

Target, the second-largest U.S. discount retailer, has become an early test case of a Supreme Court ruling that allows companies to spend unlimited amounts to sway voters in federal races. It donated to a business advocacy group, which used the funds to run an ad supporting a socially conservative Republican candidate for governor of Minnesota. Along the way, Target enraged the gay community, offering up a cautionary tale for other corporations about taking sides in political campaigns.

When the Supreme Court ruled in January that companies and unions can use their money to help elect or defeat candidates for federal office, bans on corporate spending in 24 states, including Minnesota, were in conflict. Newly freed, Target made a $150,000 donation on July 6 to a nonprofit, MN Forward. Six other Minnesota businesses, including **Best Buy**, followed suit with $100,000 gifts. MN Forward then ran an ad for Tom Emmer, an outspoken opponent of gay marriage who faces an Aug. 10 primary. The ad didn't mention Emmer's position on the issue, focusing instead on his opposition to taxes and spending.

Still, gay-rights advocates saw the donation as a betrayal by Target, which has long cultivated support among gays by, for example, providing health benefits to domestic partners and sponsoring Twin Cities Pride, an annual celebration. Since the contribution became public, as required under Minnesota law, calls for a boycott and other protests have mounted on **YouTube** and **Facebook**. "We feel betrayed," says Jeffrey Henson of Portland, Ore., who started an anti-Target Facebook group that has almost 40,000 followers. Protesters have also stood outside Target stores with placards denouncing the company.

In a letter to employees, Chief Executive Officer Gregg Steinhafel said the contribution was based solely on MN Forward's advocacy for jobs and economic growth. Target later expressed regret in a statement that it had "let down our team members and guests." Lena Michaud, a Target spokeswoman, declined to elaborate.

Target's stock seems to be holding up: Its shares closed at 51.50 in regular trading on Aug. 4, in line with the share price before the donation became public. Still, Stephen Pruitt, professor of finance at the Bloch School of Business at the University of Missouri-Kansas City, says Target is going to have to do more to make amends. "They'll knuckle under," says Pruitt, the co-author of a 1986 study of 21 consumer boycotts that showed an average drop of $120 million in market value at boycotted companies.

The dustup demonstrates the power of "private regulation," says Brayden King, assistant professor of management and organization at the Kellogg School of Management at Northwestern University. **Goldman Sachs**, which has had to defend its actions during the financial crisis, says it will not take up the court's invitation and will refrain from funding any political advertising. "There's still a market out there for reputation," says King. "Activist communities are well aware of that and will use it as a way to get leverage." —*Ira Boudway*

The bottom line *Target's experience with a campaign contribution holds lessons for companies considering whether to fund political ads.*

Investigations

The Wyly Brothers' Offshore System



Congress

The Temptations of the Ways & Means Chair

- ▶ **Rangel and two predecessors were ousted after scandals**
- ▶ **Chairmen "grow comfortable in these positions of power"**

At first glance, the writers of America's tax laws would seem unlikely candidates for congressional chicanery. Yet the 13-count ethics case unveiled on July 29 against former House Ways & Means Chairman Charles B. Rangel is the latest in a series of scandals to rock the panel.

One of Rangel's predecessors, fellow Democrat Wilbur Mills, designed the modern U.S. Tax Code as chairman from 1958 to 1975. He was brought low by his dalliances with stripper Fanne Foxe. Another Democrat, Dan Rostenkowski, who led Congress's overhaul of the tax system in 1986, was embroiled

FROM LEFT TO RIGHT: JOHN KEATLEY/REDUX; MICHAEL FAAS PHOTOGRAPHY; BETTMANN/CORBIS; WALLY MCNAMEE/CORBIS; SHAWN THEW/LANDOV

The billionaire brothers Charles and Sam Wyly (left) are well-known Republican donors. They helped bankroll the Swift Boat Veterans for Truth campaign that criticized Senator John Kerry's war record in the 2004 Presidential election. On July 29, the Securities & Exchange Commission accused them of operating a web of trusts and shell companies in the Cayman Islands and Isle of Man. According to the SEC, the system enabled the brothers to conceal $750 million in trades that should have been disclosed. The Wylys deny wrongdoing. The agency alleges that the network allowed the Wylys to make $31.8 million in one insider-trading deal. Here's how the SEC says they did it.
—Barrett Sheridan

The Trusts
The Isle of Man
The Wylys turned much of their wealth over to 17 independent trusts and more than 30 shell companies to defer paying taxes.

The Stockbroker
Dallas
Louis J. Schaufele, named in the SEC suit along with the Wylys, was the brothers' stockbroker for 15 years.

The Protector
Cayman Islands
The Wylys appointed an accountant in the Caymans as one of the overseers of the trusts, a position the SEC calls a "trust protector."

The Traders
New York
New York investment banks executed trades on behalf of the trusts. In 2000, Lehman Brothers had the business.

1 In 1999, the Wylys tell the protector to make a bullish bet on Sterling Software, which they own and secretly want to sell.

2 The protector tells the trusts, which are supposed to be independent but always take the protector's suggestions.

3 The trusts contact the broker, who devises a swap deal that amounts to buying 2 million Sterling shares at $20.29.

4 Schaufele places the trade, which Lehman understands to be on behalf of the trusts and not the Wyly brothers.

5 When Sterling shares close at $36.25 on Feb. 14, 2000, the day of its sale, the Wylys net $31.8 million.

in a scandal involving the House Post Office. He was indicted for putting friends on the payroll and buying gifts with postal funds and served 15 months in prison. Rangel, 80, relinquished the chair in March after the House ethics panel admonished him for accepting corporate-sponsored trips. A subcommittee of the ethics panel then brought charges against him, including failing to report income, use of rent-stabilized housing in New York for campaign purposes, and soliciting contributions for an institute in his name from companies with business before Congress. Rangel refused to settle the allegations with an apology and faces a congressional trial in the fall.

Such missteps are more than coincidence for the head of a panel that oversees taxes, trade, and about a third of all federal spending, including Social Security and Medicare, the health-care program for the elderly that Mills helped design in 1965. "The chairman is at the nexus of private money, interest groups, and congressional power," says Julian E. Zelizer, a historian at Princeton University. "There are big temptations." Chairmen "grow comfortable in these positions of power, and they tend to slip up a little bit around the edges," adds Ronald M. Peters Jr., a political scientist at the University of Oklahoma.

Despite the seeming hex, the committee helm remains sought after. Representative Sander Levin (D-Mich.), the temporary chairman, wants the gavel permanently come January; Representative Richard Neal (D-Mass.) is fighting him for the honor. Their weapon: campaign contributions. Neal, 61, whose state has insurance, mutual fund, and high-technology interests, has given fellow Democrats about $410,000 this election cycle. Levin, 78, who represents Detroit's industrial suburbs and has strong labor ties, has given almost $570,000. House Speaker Nancy Pelosi and other House Democratic leaders will pick between the two, unless voters decide to hand over control to the Republicans come November. Ⓑ
—James Rowley and Ryan J. Donmoyer

The bottom line *Several occupiers of the House Ways & Means chair have had illustrious careers that ended in scandal.*

Wilbur Mills
When stopped by the police in 1974, Mills' companion, stripper Fanne Foxe (right), jumped into the Tidal Basin.

Dan Rostenkowski
Indicted on corruption charges, he served 15 months in prison.

Charles Rangel
The House ethics panel in July brought 13 charges against him, including failing to report income.





With the opening of the most advanced integrated steel mill, Hyundai Steel introduces the Green Era


Production of specialized steel for automobiles


Eco-friendly closed raw material processing facilities

HYUNDAI STEEL
A MEMBER OF HYUNDAI MOTOR GROUP

Technology

The Man Who Owns 84 Percent of Facebook*

▶ **Paul Ceglia says his arrest for fraud made him remember his deal with Mark Zuckerberg**

▶ **"If this thing hadn't happened ... that contract would just be sitting in there gathering dust"**

Paul Ceglia says he never would have had an opportunity to become a billionaire if state troopers hadn't arrested him for fraud last October. The self-described environmentalist, who says he thinks illicit drugs should be legalized, manufactured wood pellets used to heat homes and was accused of failing to make deliveries to his customers.

That got Ceglia sifting through old files in his western New York home to find assets to pay back his clientele. He says he came across a document signed in 2003 by Mark Zuckerberg, then a freshman at Harvard and now chief executive of **Facebook**. He says the document is a valid contract that entitles him to an 84 percent stake in Facebook. Based on estimates of the company's value, that stake would be worth about $21 billion. Ceglia, 37, filed a lawsuit against Facebook and Zuckerberg in New York State court on June 30. What took him so long? He simply forgot about his deal with Zuckerberg, he says. "If this thing hadn't happened the way it happened, no way I would have ever started looking through these ancient folders," Ceglia says. "That contract would just be sitting in there gathering dust."

Facebook says a photocopy of the contract, filed as an exhibit to the lawsuit, is phony. "Ceglia's claims are absurd and his lawsuit is frivolous, if not outright fraudulent," the company said in an e-mail. Paul Argentieri, one of Ceglia's lawyers, says the original document is in a safe place.

Ceglia was born in Wellsville, N.Y., where he still lives. He bounced around after high school: spending two years teaching at an alternative school in Taos, N.M.; opening an ice cream stand back in New York. Ceglia says he bought and sold real estate, built and renovated



BOB VAN VORIS/BLOOMBERG

***According to a 2003 contract that Facebook insists is phony and a lawsuit it calls "frivolous"**

homes in Wellsville and the Bahamas, helped start an eco-friendly cemetery in Ithaca, N.Y., and was a founding member of the local Green Party. "I like to think about myself as someone that is driven by trying to contribute in some way to increasing the consciousness on the planet," he says on his Facebook page. He signed up in July. "It's a great service," he says.

In 2001, Ceglia was contracted by a Massachusetts company, **StreetDelivery.com**, to photograph street intersections, according to a civil complaint the company filed against him in 2003 over rights to the pictures. StreetDelivery put the photos from Ceglia and others in a database, then sold Internet access to insurance companies investigating car accidents. "I don't have much good to say about Ceglia," says Andrew Logan, founder and CEO of StreetDelivery. "He's a nice enough guy, but man, he would talk one way and then do something completely different."

In 2003, Ceglia started his own company, StreetFax, and tried to replicate StreetDelivery's business. Ceglia says he was looking for programmers and posted an ad on Craigslist. The lowest bidder was Zuckerberg, then an 18-year-old freshman at Harvard. Ceglia says the two signed a two-page contract at a hotel in Boston. According to the copy of the contract attached to the complaint, Ceglia agreed to pay Zuckerberg $1,000 to write computer code for StreetFax. Ceglia claims that Zuckerberg persuaded him to invest another $1,000 in a project Zuckerberg called "The Face Book." In return, the contract cited by Ceglia in his suit gives Ceglia a 50 percent stake in Zuckerberg's project, plus, Ceglia claims, an additional 1 percent interest for each day after Jan. 1, 2004, that the launch of The Face Book was delayed. Although Zuckerberg missed deadlines, Ceglia says he was happy with the future CEO's work. "If at some point in the future I start running Facebook," Ceglia says, "I guess I'm going to have to hire him to keep running the company."

Lisa Simpson, a lawyer for Facebook, said at a court hearing on July 20 that Zuckerberg did sign some contract with Ceglia. What Zuckerberg didn't do, she added, is sign over an interest in Facebook to Ceglia. Facebook argued in court papers that Zuckerberg couldn't have given Ceglia a share of a project he didn't conceive of until a year later.

Ceglia lives with his wife, Iasia, and two young sons in an unpainted wood house about two hours southeast of Buffalo, where Ceglia's suit against Zuckerberg and Facebook is pending in federal court, after Facebook

Technology



Cerberus bets on the gun trade page 41 ▶

transferred it from state court. "Things change," says Ceglia, standing outside the closed pellet-making shop, which he says he built with the help of two Amish men in an enlarged two-car garage near his house. "Here I am in my little factory, and Zuckerberg is now a mogul."

He says he and Iasia started the pellet business in February 2009 to turn reclaimed wood into fuel for eco-friendly heating. "We felt like we had heard Obama's call to help America become energy-independent," he says. Nine months later, on Oct. 30, state police arrested the Ceglias after receiving more than two dozen complaints from customers who said they'd paid for pellets but hadn't received any. The couple was charged in state court with one count of a first-degree scheme to defraud and 12 counts of fourth-degree grand larceny.

According to prosecutors, who won a court order to shut the business in December, the Ceglias received $200,000 in prepaid orders from about 130 customers for 1,900 tons of pellets. The Ceglias told the state troopers that the company did fulfill three orders and refunded 10 to 20. (It wasn't Paul Ceglia's first run-in with the law: In 1997 he pleaded guilty to possession of hallucinogenic mushrooms, according to Panola County [Tex.] court files. He was fined $15,000.) If the State of New York would just let him start selling pellets again, Ceglia says, he'd be able to pay back his customers. For now, he's trying to mortgage property to help pay for the refunds.

$21 BILLION

Estimated amount Ceglia's Facebook stake may be worth if his claim is valid

Lawyers for Ceglia and Facebook were expected to file papers by Aug. 6 setting a schedule for preliminary matters, including a deadline for Facebook's response to the complaint. Ceglia says he's surprised his claim has gotten so much attention. He mostly ignores the phone calls he's been getting from journalists and talk radio hosts like Howard Stern and Matthew Erich "Mancow" Muller. "Once I picked it up because I thought I knew the number," he says. "And I'm, like, live on the Mancow show." —*Bob Van Voris*

The bottom line *Ceglia says he forgot about his 2003 contract with Zuckerberg. Facebook calls Ceglia's claims "absurd."*

Drawing Board



Videoconferencing

Virtual Meetings for Real-World Budgets

- ▶ A New Jersey startup offers an alternative to high-end systems
- ▶ "We want to connect millions of people," says Vidyo's founder

At most companies, videoconferencing has yet to evolve from a technological parlor trick into an everyday utility like e-mail. One reason is there's no cheap and easy way to make it available on all the devices people use. Even companies that opt for top-of-the-line equipment from **Cisco Systems** or **Hewlett-Packard** often pay nearly $1 million to upgrade the underlying corporate network, says IDC analyst Jonathan Edwards.

That's why tech industry veterans are keeping a close eye on **Vidyo**, whose technology will soon be sold by HP. The 120-person startup, based in Hackensack, N.J., makes software it says can run on almost any device that connects to the Net—and adjusts whether that's a high-speed link in the boardroom or a cell connection from the 18th hole. While most companies buy a few high-end videoconferencing systems for executives, "We want to connect millions of people," says Vidyo Chief Executive Ofer Shapiro.

The aim is to bridge the gap between traditional systems costing up to $300,000 for a just-like-being-there telepresence room and cheap but low-quality PC-based services such as **Skype**—and in a way that lets people using all of these options participate in calls together.

Shapiro worked as a technologist for the Israeli Army before joining Tel Aviv-based videoconferencing supplier **Radvision** in the late 1990s. In 2005 he founded Vidyo—and opted not to pour money into another hardware product. Instead his team focused on implementing a little-used software approach called scalable video coding. The technology strips out data so that devices with weaker signals can maintain a good picture without expensive back-office gear. The program, which runs on a PC, costs $6,000, says Shapiro. Another plus: Vidyo's software can be tweaked to run on new devices. Shapiro says it took his engineers two weeks to have a



Shapiro aims to bridge the gap between pricey and basic videoconferencing

test version that could work on **Apple**'s iPad. "It lets you make calls on crappy connections, and it's an order of magnitude or two cheaper than dedicated video calling gear," says Andrew W. Davis, an analyst with industry research firm Wainhouse Research.

That's where HP comes in. In June it announced a deal under which it will bundle Vidyo software on business PCs so workers can make video calls from their desks. HP will also adapt its own high-end telepresence system, dubbed Halo, to work with Vidyo's technology so corporate buyers can use them without million-dollar network upgrades. While HP has existing contracts to sell gear from **Polycom** and others, it will be marketing Vidyo's technology under its own brand. Wainhouse's Davis also expects HP to put Vidyo's software on mobile devices, such as phones and tablets being developed by recently acquired **Palm**. "It's a key component in our strategy to make HP the videoconferencing provider of choice for enterprise customers everywhere," says Rob Scott, general manager of HP's Halo unit.

Without HP's support, Vidyo is just another promising startup. As the world's biggest PC maker and a prime supplier of corporate tech, HP could bring Vidyo and videoconferencing to the corporate mainstream. Analysts expect HP to use Vidyo to distinguish HP's computers and mobile devices from products made by rivals such as **Dell** and Apple. It could also help HP build up its $35 billion-a-year a consulting business by advising companies on how to use videoconferencing to lift productivity.

It's unclear, however, whether HP will aggressively pursue this video calling market. Although it introduced its Halo system a year before Cisco unveiled its own telepresence product, HP has just 3 percent of the videoconferencing market, compared with 45 percent for Cisco, estimates Davis. "Vidyo could be an important weapon for HP, but it all depends on what they do with it," says Chuck House, a retired HP executive who now advises Vidyo's board. He points out that Cisco CEO John T. Chambers promotes videoconferencing every chance he gets, "but you never hear HP say anything about it. It's an afterthought." —*Peter Burrows*

If Vidyo's model works, users of all types of videoconferencing systems will be able to talk together

The bottom line *Vidyo's software may help make telepresence-quality videoconferencing systems part of the corporate mainstream.*

Mobile

We Take Cash, Plastic, And ... Smartphones

- **A new cell-phone payment system may threaten Visa and MasterCard**
- **The plan by AT&T, Verizon Wireless, and others is "a game changer"**

Smartphones may soon displace some of the estimated 1 billion credit and debit cards in American wallets. **AT&T**, **Verizon Wireless**, and **T-Mobile** are planning a venture to develop a mobile payment system that works with smartphones, posing a new threat to **Visa** and **MasterCard**, three people with direct knowledge of the plan say. The partners aim to test the system at stores in Atlanta and three other U.S. cities, the people say, though they didn't provide a timetable. The trial would be the carriers' biggest effort to spur mobile payments in the U.S. "This is definitely a game changer," says industry consultant Richard K. Crone. Mobile carriers "are the biggest recurring billers in every market. They are experts at processing payments."

While the technical details are sketchy, the service would let customers make purchases by holding a smartphone in front of an electronic reader in stores. Transactions would be processed by **Discover Financial Services**, the fourth-biggest payments network in the U.S. behind Visa, MasterCard, and **American Express**. London-based **Barclays** would help

ILLUSTRATION BY PATRICK CORRIGAN/TORONTO STAR/CAGLE CARTOONS; PHOTOGRAPH BY HEATHER JOHNSON FOR BLOOMBERG BUSINESSWEEK

Technology

27

PERCENT

U.S. smartphones that used Google's Android operating system in the second quarter—passing Apple's iPhone, with 23 percent.

DATA: NIELSEN

manage the accounts, say the people, who requested anonymity because of confidentiality agreements. Representatives for the carriers, Barclays, and Discover declined to comment.

Retailers may be eager to support a rival network after years of tussling with Visa and MasterCard over transaction fees. "We have long argued that real competition is missing from today's payments market," says Brian Dodge of the Retail Industry Leaders Assn., which represents merchants such as **Wal-Mart**, **Home Depot**, and **Target**. "A secure and reliable competing network that ... reduces retailers' costs would be welcomed news."

Visa and MasterCard are benefiting as people abandon cash and paper checks for cards and electronic payments, which account for more than half of U.S. consumer purchases, compared with 36 percent in 2003, according to *The Nilson Report*, an industry newsletter. Visa and MasterCard accounted for $2.45 trillion, or 79 percent, of $3.1 trillion in U.S. consumer spending last year on credit and debit cards. More than half of U.S. consumers, and almost 80 percent of those between the ages of 18 and 34, will use mobile financial services within five years, according to Mercatus, a consulting firm in Boston.

Any new payment system may face barriers that prevent the technology from taking hold quickly in the U.S., the Federal Reserve Bank of Boston said in a May policy paper. Consumers won't demand mobile payments "until they know that enough merchants accept them, and merchants will not implement the technology until a critical mass of consumers justifies the cost of doing so," the report said. Merchants would have to spend an estimated $200 per electronic reader, and updating mobile phones with embedded microchips would increase manufacturing costs by $10 to $15 per handset, according to the Boston Fed. That may be worth the money if accepting mobile payments allows retailers to send rewards and information about promotions to their customers' phones at checkout.

Visa and MasterCard are investing in their own mobile payment systems. MasterCard has worked for years with carriers, handset makers, and banks on developing mobile payment technologies in countries around the world, including Japan, Turkey, and the U.K., Chief Executive Ajay Banga said in an Aug. 3 conference call with analysts. "While the business model for mobile payments is yet to be proven in a tangible way across the world, I have no doubt that it will get proven in some form," he said. —*Peter Eichenbaum and Margaret Collins*

The bottom line *A smartphone payment system from AT&T, Verizon Wireless, and T-Mobile could turbocharge mobile payments in the U.S.*

Quoted

"I don't think Google or anyone else can make a strong argument that they need $30 billion. I'd rather have the cash in my own pocket than have all of it sitting on the balance sheet."
—Kenneth A. Smith, a portfolio manager at Munder Capital Management



Social Search

Q: Will Question-Asking Become Big Business?



- **Q&A sites say some queries are best fielded by humans, not Google**
- **Social search will "be worth a ton of money in the long run"**

If you've ever thought to yourself, "Why is Angelina Jolie famous if all of her movies are just O.K.?" you're in luck: Forty-two people have weighed in with an answer at **Fluther.com**. Fluther is one of a dozen or so sites that have sprung up in the past two years aiming to tap the wisdom of crowds and supply human answers to questions search engines don't handle well. Such "social search" accounts for about 4 percent of the total search market, according to Matt Booth, an Internet analyst with market research firm Kelsey Group. And it's growing fast. "It's going to be worth a ton of money in the long run," Booth says.

Some of Silicon Valley's biggest companies and investment firms are diving in. In February, **Google** bought **Aardvark**, one of the first social search sites, for $50 million. The next month, **Benchmark Capital** invested in **Quora**, a Q&A site begun by two former **Facebook** engineers, valuing it at $86 million before it even opened to the public, according to tech blog TechCrunch. (By contrast, publicly traded **Answers Corp.** is worth about $62 million.) On July 28, Facebook introduced its 500 million members to its Facebook Questions feature.

The attraction to business of this new flavor of search is that as users pose and answer questions, they'll reveal more data about themselves and create discussion threads against which ever more targeted advertising can be sold. "There are a lot of advertising signals when people ask questions," says David Hornik, a principal with August

Capital, a backer of Aardvark.

The proliferation of sites such as Fluther, Quora, **ChaCha**, **SircleIt**, **Hunch**, and **PeerPong** raises its own question: How will they make money? Most Q&A sites will need "tens of millions or hundreds of millions of users before the revenue picture looks interesting," says Leonard Speiser, a Silicon Valley entrepreneur and former eBay and Yahoo! executive who advises Fluther. Traffic numbers for Q&A sites that can't tap the user base of a Google or a Facebook are still well below that threshold.

As their audience grows, these sites face a quality control problem. Quora was once an invitation-only site, and its discussions attracted notable names from the technology world, such as Craigslist founder Craig Newmark. Now that Quora has opened to the public, some users are complaining. "The startup grows past a certain point, the crap floods in," wrote one commentator named Greg Linden on a tech blog.

Some Q&A sites see a future in turning a smaller group of loyal users into consumers. That's the route of New York-based Hunch. It will earn money from retailers' referral fees and other businesses, says co-founder Chris Dixon. The company is developing algorithms to recommend products when people pose commerce-related queries. As the system learns more about its users, Dixon says, the recommendations should become smarter.

Other companies consider access to high-quality answers a product in and of itself. "What if you did a search and got people instead of just sites?" asks Ro Choy, chief executive of PeerPong, which is building an index of users' interests and activities pulled from their **Twitter** and Facebook accounts. That database will help San Francisco-based PeerPong identify experts, and the company believes question askers will pay for quality help in finding, say, the best breast cancer specialist in downtown Seattle.

Even if some of the sites fail, plenty of investors think someone will figure out how to make money in Q&A. As Dixon puts it: "Who knows what's going to work on the Internet? People were saying 10 years ago, 'How does Google make any money?'" Ⓑ —*Justin Bachman*

The bottom line *Q&A sites are proliferating online and generating investor interest. They could prove to be a valuable venue for targeted advertising.*

FROM LEFT: ANDREW UNANGST/GETTY IMAGES; ILLUSTRATION BY GREG MABLY; JOHN KEATLEY/REDUX

Innovator

Blaise Agüera y Arcas



The architect of Bing Maps and Mobile says phones in the near future will automatically identify landmarks and tell you all about them

Blaise Agüera y Arcas arrived at Microsoft in 2006 when the software giant bought Seadragon, a startup he'd founded. The company had developed technology allowing viewers to zoom in and out of large images quickly—and that expertise attracted the attention of the team working on Microsoft's search engine, now known as Bing, and related products. Agüera y Arcas is in charge of developing features that will help Bing compete against Google in the mobile realm, where Bing has just 4.2 million users in the U.S. to Google's 33.1 million, according to comScore.

The latest version of Bing's iPhone app, released in June, is a start. The app includes so-called augmented reality features, which overlay computer data on real-life images, such as the view from a smartphone's camera. The Bing app can scan bar codes as well as book or DVD covers and return product information like reviews, prices, and links to merchants' sites.

An upcoming version of Bing Maps for mobile phones will bring this technique to geographical landmarks as well. Agüera y Arcas says that in the near future a Bing-equipped phone will be able to scan and identify landmarks—the Eiffel Tower, say—then automatically provide hours of operation, reviews of nearby restaurants, and other relevant information. "All this stuff is happening," he says. "We're not talking about things that are 20 years out or even 5 years out."

Agüera y Arcas' team at Microsoft is also working on ways to introduce more information into the version of Bing Maps that people use from a PC. While street-side views of building exteriors have become common in online maps, at the Technology, Entertainment, Design Conference in Long Beach, Calif., earlier this year, Agüera y Arcas revealed a new feature that takes Bing Maps users inside the buildings, providing a panoramic view of the interior. He is encouraging store owners and tourists to submit their own photos of interiors and automatically pulling public photo sets from Flickr. Microsoft software will stitch them together to create virtual representations of real places that users can explore.

"It's a way of wikifying the physical world," says Agüera y Arcas. That's similar to how Wikipedia built the world's largest encyclopedia through the work of volunteers.

It's an ambitious goal, especially for a former Princeton physics student who has never taken a formal computer science course. Agüera y Arcas was curious about electronics and programming even as a six-year-old growing up in Mexico City. By 2003, when he founded Seadragon, he'd turned his attention to computers full-time. "My attraction has never been to computers per se, but to the fact that they offer a highly leveraged way to invent magic," he says. Ⓑ —*Dina Bass, with Helen Walters*

Past ▸ Studied theoretical physics and applied mathematics at Princeton

Present ▸ Creating replicas of building interiors on Bing Maps

Future ▸ Enabling phones to scan and identify landmarks

Add value to your already-valued opinion.

The new Bloomberg.com gives you nonstop business news and data from across the globe. With a fresh new look, intuitive navigation and comprehensive coverage when you need it, Bloomberg.com is the source for those who like to be the source.

More power to you.

The new
Bloomberg.com

© 2010 Bloomberg L.P. All rights reserved.

Contents ▶ A Chinese ratings firm takes on S&P, Moody's, and Fitch 42 ▶ Winning hedge funds are wary 43 ▶ The woman behind Rothschild's China push 45 ▶ Charlie Rose talks to investor Wilbur Ross 46 ▶ The golden age of mining takeovers 48 ▶ Bid & Ask: Churchill's dentures 49 ● Edited by Eric Gelman



Cerberus' Adventures In the Gun Trade

▶ **Founder Steve Feinberg makes a big investment in firearms that has yet to pay off**

▶ **"With the Obama surge ending, it doesn't look so obvious"**

Randy Luth was surprised to learn in 2006 that **Cerberus Capital Management** wanted to buy his St. Cloud (Minn.) business. What would Manhattan financiers known for investing in distressed debt and troubled companies want with **DPMS Firearms**, a manufacturer of semiautomatic rifles?

Cerberus had more than DPMS in its sights. From April 2006 to January 2008 it bought three other firearms companies: Bushmaster, Remington, and Marlin. And it kept adding to its collection. Cerberus now controls 13 brands in a holding company it created, Madison (N.C.)-based **Freedom Group**. With sales of $848.7 million in 2009, Freedom Group is the largest gun and ammo maker in the U.S. That means Stephen A. Feinberg, Cerberus' founder and managing member, is the country's top civilian gun magnate.

Cerberus' gun play is one of the latest moves for the secretive Feinberg, 50, who founded Cerberus in 1992 to buy the debt of struggling companies. The firm's strategy evolved over the past decade to include private equity takeovers, and its assets have grown to about $23 billion. Cerberus' investments have ranged from biotech firm **Talecris Biotherapeutics** to Japan's **Aozora Bank**. In 2006 and 2007, Cerberus led a group of investors that paid a total of about $15 billion to buy a majority stake in **GMAC** and about 80 percent of **Chrysler**. Cerberus cut its GMAC position to less than 15 percent as part of a government bailout and saw its stake in Chrysler's auto operations wiped out when the company went bankrupt in 2009. It kept its stake in Chrysler's financing business.

ILLUSTRATION BY TOPOS GRAPHICS; BULLET HOLES: CASPAR BENSON/GETTY IMAGES

Christina Romer on the jobless rate page 54 ▶



Luth, the rifle maker, says that when he arrived at Cerberus' Park Avenue offices to negotiate a deal in 2007, he discovered that Feinberg and several of his partners "are real gun guys." Feinberg stalks pheasant in upstate New York and has taken a bull elk in Colorado, according to hunting buddy T.K. Duggan, a New York money manager. "He's a dedicated sportsman, nothing fancy," says Duggan. He adds that as far as his friend is concerned, "what your hobby is doesn't determine what you do with your investors' money." Cerberus closed on the acquisition of DPMS in December 2007 for an undisclosed sum.

For a while, the roll-up looked smart. The election of Barack Obama in November 2008 had firearms buffs worrying about possible gun prohibitions. Consumers stocked up on guns and ammo throughout 2009. Freedom saw sales rise 17 percent for the year and posted net income of $54.4 million, vs. a loss of $28.6 million the year before.

Then President Obama proceeded to do nothing on gun control. With no new restrictions on the horizon, "Freedom Group was thought to be a huge home run," says Steven M. Davidoff, a law professor and private equity expert at the University of Connecticut. In October 2009, Cerberus filed with the Securities & Exchange Commission to take Freedom public. Eight months later, gun sales are slowing and Feinberg hasn't pulled the trigger on the initial public offering. "The equity market isn't as welcoming [to IPOs] as it was just a few months ago," Shelly Lombard, an analyst at Gimme Credit, said in a June 2 note to clients about Freedom.

One reason for assembling a portfolio of brands was the potential for cross-selling—a Remington shotgun dealer can recommend Freedom-made ammo. With sales slumping, it's not clear whether that strategy will pay off. "On paper, it made lots of sense in 2008 and 2009," says Cameron Hopkins, an industry consultant in Henderson, Nev. "Today, with the Obama surge ending, that doesn't look so obvious."

A Cerberus spokesman declined to comment, citing the quiet period in advance of Freedom's pending IPO. Linda Powell, a spokeswoman for Freedom, said the holding company "is really just a financial creation of Cerberus. We want our customers to focus on Remington and our other historic brands."

Speaking by cell phone on his way to a shooting tournament, Luth, who has retired, says Cerberus' roll-up was "a brilliant strategy" to achieve marketing efficiencies. In an SEC filing in May, Freedom reported that it is No. 1 in the U.S. in shotguns (31 percent market share); traditional rifles (37 percent); modern military-style rifles (48 percent); and ammunition (33 percent).

The company's latest financial results are less impressive. Earnings for the first quarter of 2010 fell 58 percent, to $5.6 million, compared with the same period in 2009; first-quarter sales dropped 9 percent, to $174.2 million. In the May filing, Freedom acknowledged that the Obama-related jump in ammo sales was easing. "As a result," it said, "we may experience a decline in sales and/or net income [in 2010] as compared to prior fiscal years, and these declines may be material." Industrywide, U.S. revenue from small arms and ammo is expected to dip 5.7 percent in 2010, to $9.8 billion, according to the research firm IBISWorld.

Cerberus has not soured on the security sector. In April it agreed to acquire **DynCorp International**, a large defense contractor based in Falls Church, Va., in a deal valued at $1.5 billion, including the assumption of debt. The deal, Cerberus managing director Timothy Price said in a statement, "underscores our successful record in the government services sector and furthers our goal of continuing to grow our portfolio in this area." *—Paul M. Barrett and Jason Kelly*

The bottom line *What looked like a great strategy with gun sales rising looks less promising now that fears of new gun control efforts have subsided.*

Quoted

"Many investors want to forget the last 10 years, which featured the two worst bear markets since the Great Depression. We're not likely to see double-digit stock returns in the coming 10 years. ... But two disastrous market decades in a row is extremely unlikely."
—BlackRock Vice-Chairman Robert C. Doll





Credit Markets

Ratings with Chinese Characteristics

▶ **A mainland debt analysis firm takes on S&P, Moody's, and Fitch**

▶ **"Without a challenge ... the big rating agencies won't improve."**

Guan Jianzhong, the head of one of China's three big credit rating agencies, sees the criticism of **Standard & Poor's**, **Fitch Ratings**, and **Moody's Investors Service** for their role in the global financial crisis as creating an opportunity. He wants his firm, Dagong Global Credit Rating, to enter the U.S. market. "Without a challenge to the status quo, the big ratings agencies won't improve their methodologies on their own," says Guan, who is Dagong's chairman.

Dagong, which has never rated a company outside China, made a splash with its first analysis of international sovereign debt, which it issued on July 11. The report, covering 50 nations, awarded the Chinese government a higher credit rating, at AA+, than the U.S., the U.K., and Japan. Guan says

FROM LEFT: DANIEL ACKER/BLOOMBERG; AUDE GUERRUCCI/BLOOMBERG; NELSON CHING/BLOOMBERG; DANIEL ACKER/BLOOMBERG



Guan's Dagong gave China a higher rating than the U.S., U.K., or Japan

the results highlight the differences between Dagong's approach and that of its rivals. The established agencies, he says, tilt their ratings to reflect "their beliefs and ideology" and the "interests of the borrowing countries" in the West. They place too much emphasis on the nature of a country's political system, the independence of the central bank, and per capita gross domestic product.

Dagong, in contrast, focuses on a country's fiscal health, foreign currency reserves, and ability to create wealth. The big developed countries like the U.S., Britain, and Japan, says Guan, use "over 90 percent of the world's credit resources, but their GDP growth doesn't contribute a lot to the world economy, especially after the financial crisis."

A graduate of Shanxi University of Finance & Economics, Guan worked in finance in New York for several years before returning to China. He became Dagong's chairman in 1998. Last month he was elected director of the government-backed industry group, the China Securities Credit Rating Committee.

Dagong was founded in 1994, a decade after state-owned firms were allowed to issue bonds in China. In December 2009 it spent 10 million yuan ($1.48 million) to prepare and submit an application with the U.S. Securities & Exchange Commission to become a recognized ratings firm. The SEC will hold a hearing on the application in September. The SEC has granted recognition to 10 ratings firms, with only two based outside of North America, both in Japan.

"They certainly picked a good time–global confidence in the existing ratings agencies is probably at an all-time low," says Tom Orlik, China economist at Stone & McCarthy Research Associates in Beijing. Yet it's not clear that Dagong has developed the credibility to compete globally. "Whether they'll be able to successfully push that outside of China, where's there's deep suspicion about the cozy relationship between government and companies, is difficult to foresee," says Orlik.

Like S&P, Moody's, and Fitch, Dagong is paid by the companies it rates. Guan says issuers, especially politically connected companies, also shop around among mainland agencies for the best rating. Gaun says his firm does not allow government connections to influence its ratings. "We want to be an internationally renowned credit-rating agency," he says. "Because of this, we can't provide ratings that aren't independent."

During a time of market anxiety over big budget deficits in the U.S. and Europe, Dagong could become a powerful player given China's trade surpluses and enormous foreign exchange holdings. "It's to their benefit that they're adding the voice of the world's largest global creditor," says William Hess, managing director at China Analytics, an economic research firm in Beijing. "If and when [Chinese investors'] funds start to follow the ratings coming out of China, then that's something that would really make markets sit up and notice."

It takes time to establish that kind of presence. Dagong should focus on China to "build up their reputation and influence," says Wang Yang, co-head of fixed-income research at UBS Securities in Beijing. "At this point, I don't think they are ready to expand globally."
—Henry Sanderson

The bottom line *With Western credit ratings firms under fire, China's Dagong sees an opening to expand in the U.S. and other foreign markets.*

Money Managers

Why Winning Hedge Funds Are Wary



▸ Investors who dodged the crisis are uncertain about what's ahead

▸ "While I'm not expecting ... a disaster, the consumer is weak"

The promise of hedge funds is that they have the freedom to move quickly in and out of different assets, and to bet prices will go down as well as up. That flexibility allows them to make money in any kind of market. In the turbulent conditions since 2007, however, few have delivered consistent profits.

Of 2,799 hedge funds studied by PerTrac Financial Solutions, a New York investment-software company, only 321 were agile enough to post gains every year since 2007 and in the first part of this year. Among the best performers: **Perella Weinberg Partners Xerion**, managed by Daniel J. Arbess (above), up a total of 95 percent from January 2007 through May; **Waterstone**, up 84 percent through June; and **Banyan Capital**, up 56 percent through June.

Notably absent from the consistent winners list: managers with top long-term returns, such as Steven A. Cohen, Louis M. Bacon, and Kenneth C. Griffin, who each posted their worst losses ever in 2008. Then there are the almost 3,300 hedge funds that have shut down since the start of 2007. As a group, hedge funds gained an average 10 percent for investors in 2007 and lost a record 19 percent in 2008 before rebounding 20 percent last year, according to Hedge Fund Research. The industry has lost 0.21 percent this year through June.

The winners made money through a combination of prescient investment calls, executing smaller trades with shorter time durations, which enabled them to get out of unprofit-

Markets&Finance

able positions sooner, and raising cash before markets slumped in 2008. Arbess, who manages $2.1 billion at Xerion, started shorting collateralized-debt obligations tied to subprime mortgages at the end of 2006. David Gerstenhaber of **Argonaut Macro Partnership**, profitable every year since its launch in 2000, bet in the middle of 2008 that European interest rates would fall and in September of that year shorted the euro.

What do these managers see ahead? In interviews and investor letters, they say they expect the U.S. and European economies to slow. Gerstenhaber, 49, plans to bet against industries that do poorly when the economy loses steam, such as materials, energy, and homebuilding. He and Arbess favor investments tied to emerging markets.

Shawn Bergerson, founder of **Waterstone Capital Management**, says he's betting against consumer-related stocks because he sees Americans curtailing spending and reducing debt amid high unemployment. "While I'm not expecting a major economic crisis or a disaster, the consumer is in a weak position," says Bergerson, 45, who oversees $1.17 billion from his office in Plymouth, Minn.

With the outlook so unclear, the $1.65 trillion hedge fund industry is taking less risk, using less debt, and making fewer trades, according to data from securities exchanges and brokers including Credit Suisse and JPMorgan Chase. Laurence Benedict, founder of $804 million **Banyan Capital** in Boca Raton, Fla., says he has reduced the size of his trades to about a third of what they usually are, and to the lowest since October 2008, because of uncertainty over the economy. "It's difficult to get conviction in this environment," says Benedict, 48, who holds trades for no longer than five days. "There will be more clarity by the third quarter following the release of economic indicators."
—*Saijel Kishan*

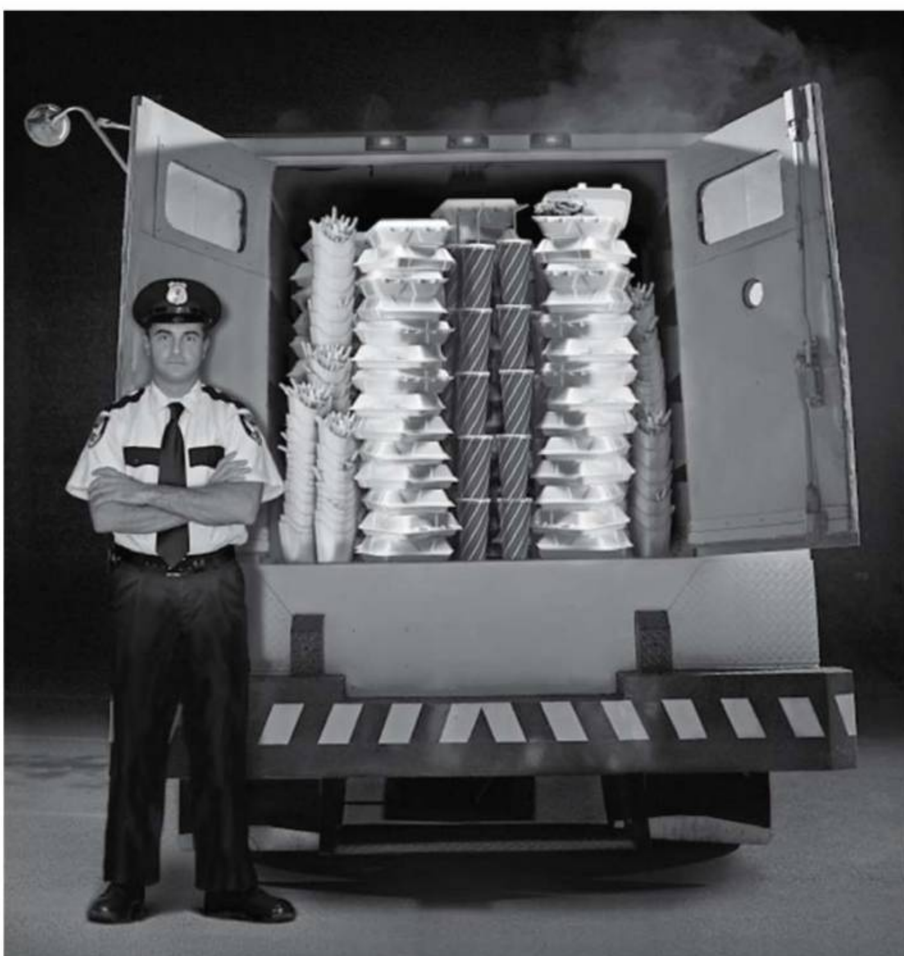
The bottom line *Even some hedge fund managers who have proven their ability to anticipate trends lack conviction about the economic outlook.*

2.6

PERCENT

The drop in the index of pending sales of existing homes from May to June. Economists had projected an increase of 4 percent.

DATA: NATIONAL ASSOCIATION OF REALTORS



That 9 dollar lunch is worth more than you think. Like 19,000 dollars more.

Pack your own lunch instead of going out. $6 saved a day x 5 days a week x 10 years x 6% interest = $19,592. That could be money in your pocket. Small changes today. Big bucks tomorrow. Go to feedthepig.org for free savings tips.



Ad Council
AICPA FOUNDATION

Investment Banking

The Woman Leading Rothschild's China Push

▸ Jennifer Yu wants to build the firm's reputation in a fast-growing market

▸ "The economic balance of power ... is moving to the East"

When Jennifer Yu, **Rothschild**'s top executive in China, wanted the firm to advise Chinese carmaker **Zhejiang Geely** on its bid for **Volvo**, some colleagues at the bank's headquarters in Europe were skeptical. A senior banker asked her how a "mouse" like Geely could swallow an "elephant" like Volvo. "There's a dragon behind this mouse, and it's China," Yu recalls answering. She and the team handling Geely won the argument, and Geely won the bidding. It completed the takeover of Volvo from **Ford Motor** for more than $1.3 billion on Aug. 2.

Rothschild, the more-than-200-year-old family-controlled banking dynasty, is making a big move in China, and Yu is leading the charge. It plans to add 15 merger advisers there by March, giving it 55 in all, more than any foreign investment bank, says Olivier Pecoux, co-chief executive officer of Rothschild. Today, the merger business in China is still relatively small. So far this year, China has accounted for about 9 percent of the $1.1 trillion in deals around the globe, according to data compiled by Bloomberg. The potential, though, is enormous. China has $2.5 trillion in untapped foreign currency reserves and is mandating that state-owned companies expand abroad to secure natural resources such as oil and metals. "The economic balance of power has already changed, and it is moving to the East," says Yu, whose title is head of greater China. "There will be an increasing number of Western companies selling assets to China."

The firm hopes to build on the momentum of the Geely deal, which catapulted it to No. 8 among merger advisers in China so far this year, from 19th in 2009, according to data compiled by Bloomberg. That's nine places higher than Rothschild's ranking in North America, where it employs 150 bankers. Rothschild this year helped **Royal Dutch Shell** on its joint $3.1 billion bid for Brisbane (Australia)-based **Arrow Energy** with **PetroChina,** China's biggest offshore energy explorer. Rothschild is advising Beijing-based **Citic Securities**, the mainland's largest brokerage by market value, on creating a global equity brokerage with France's **Crédit Agricole**. "Clearly, under the leadership of Jennifer, and with the support of the senior manage-



Yu sees more Chinese companies buying Western assets

"NATURAL GAS WILL PROVIDE AN INCREASING SHARE OF AMERICA'S ENERGY NEEDS OVER THE NEXT SEVERAL DECADES."

NY TIMES, JUNE 2010

Natural gas is grabbing headlines across the country. For good reason.

This summer, MIT scientists concluded a two-year study, "The Future of Natural Gas," that calls for greater use of natural gas in power generation and transportation. Read for yourself what *The New York Times* and other leading publications are saying about MIT's new report.

Visit cleanskies.org to learn more.

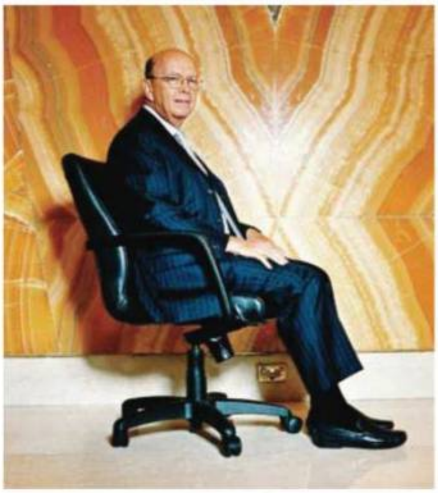
AMERICAN CLEAN SKIES FOUNDATION

www.cleanskies.org

WHAT ARE WE WAITING FOR? PUT AMERICAN NATURAL GAS TO WORK FOR AMERICA NOW.

Charlie Rose talks to

Wilbur Ross



Investor Wilbur Ross, who specializes in restructuring failed companies, talks about troubled banks, the state of U.S. manufacturing, and taxes

Here you are buying banks, small banks. You're not dissuaded by the new financial regulatory reform?
No, not at all. I think having a kind of catastrophic insurance policy is a good idea. And I think that if people do risky things they should put up more capital and that the really big banks that could endanger the system should put up more capital than smaller banks.

Your plan is to buy a lot of these banks and then consolidate them?
Here's what we've been doing. The first one we bought was in Florida, a bank called BankUnited. It had been making very toxic loans, option-adjustable-rate mortgages. And they were extending a lot of that to foreigners who were speculating in South Florida real estate. Well if you're lending 90 percent or 100 percent, and the guy doesn't have to pay interest for five years, and he lives in Venezuela or some other jurisdiction, you can imagine the collections problems when the market went down. So they failed. We brought in a new [manager], a guy named John Kanas. John had built up North Fork Bank from a little bank in Long Island and made it a $60 billion bank. He and I made a joint venture about two years ago. And we bought BankUnited. It's worked out very well.

You worked for a number of years for Rothschild.
Yes, for about 25 years. I had been running the restructuring advisory practice on a global basis, but in 1997 also started a fund to invest in bankrupt companies. I went to the management of Rothschild and said ... I'd like to buy the fund from you. On April Fool's Day, 2000, I went into business for myself.

Then you started looking at the steel business?
Around mid-2001. I had done the first LTV bankruptcy half a dozen years before. The second one was a real mess, and [LTV] was in danger of being totally shut down. I went to the leader of the United Steelworkers and said we'll buy this and we'll revitalize it, but we need a contract that's different from the contracts you've had. It turned out he was looking for someone to do just that.

Then the next year you bought Bethlehem Steel.
Yeah, we became the most efficient steel company in America. We were making steel with less than one man-hour per ton. The Chinese at the same time were using six man-hours per ton.

So why did you sell it?
We didn't sell it so much as merge it with Mittal. We had gotten to a one-third market share of the U.S., so there was not much more we could do here. Mittal was in a lot of the emerging markets.

Does manufacturing in the U.S. have a future?
I think it does. What I'm worried about is R&D. You have to have new technologies. We think of China as a polluter. Let me tell you, China is the leader in wind power technology. They already are producing 40 percent of all the wind turbines in the world and exporting 80 percent of those. And they did it in typical Chinese fashion. They ordered that the power grid must take alternative power before it can take anything else. Second, it must do it under long-term contracts, and third, it must do it at a big premium price. So they managed to create a huge domestic market, and now they're beaming in on the export. That's how you have an industrial policy.

And we don't have an industrial policy at all in this country.
No, nor do we have an energy policy.

Here you are, a man who is worth more than a billion dollars. And you're saying what we need from the government is policy.
Yes. I really feel that within 5 or 10 years, we could be a second-rate power. We'll still be big, but we could be behind the eight ball in a big way.

Do you have a solution?
Stepping up R&D budgets would be a good thing, spending more on universities. I think those are more important even than tax policy and other things.

[Congress may] extend a Bush tax cut for people who make under $250,000. But for people like you ...
That's O.K. as long as they do something useful. I think it is important to keep the tax cut for people below $250,000. If you want to destroy consumer spending, just eat away at the middle class. Median income in this country went nowhere the whole decade of the 2000s. But people want to live a little better than they did the year before. And the only solution they could find was to borrow. That sociological phenomenon, I believe, is what ultimately led to the subprime crisis. Ⓑ



Watch Charlie Rose on Bloomberg TV weeknights at 8 p.m. and 10 p.m.

BRAD TRENT


REFINED
DISTINCT
STYLISH
The NEW TRIUMPH® 537RT Retractable Gel is the new standard in smooth writing. Experience the control and stylish design of the full line of TRIUMPH roller and retractable gel pens.
NEW
BiC®
TRIUMPH
537RT
RETRACTABLE GEL
BiC More for your money
ROLLER
GEL
ROLLER
©2010 BIC USA Inc., Shelton, CT 06484

Nº8

Rothschild's ranking among merger advisers in China this year

ment team, we are making meaningful progress in China," Chairman David de Rothschild writes in an e-mail.

A Shanghai native, Yu, 47, graduated from the Shanghai University of Finance & Economics. Her decision to study in China and work there after graduation gave her time to build connections, or *guangxi*, with government officials and corporate executives, many of whom were her classmates and friends, she says, declining to identify them.

Yu joined Rothschild in 2003 from **BNP Paribas**, where she focused on underwriting initial public offerings. She became head of China operations for Rothschild in 2005 and was promoted to her current role three years ago. In a country where the government often plays a key role in mergers and acquisitions—deciding, for example, which companies can bid for overseas assets—Yu's deep roots and extensive connections make her an effective dealmaker. "She knows what is doable or not in the Chinese environment," says Pecoux.

Yu's first major client at Rothschild, **Shanghai Automotive Industry**, bid for U.K.-based **MG Rover**, which was ultimately bought by **Nanjing Automobile** in 2005. Yu told her client not to worry—it would eventually own the Nanjing carmaker because the government would force consolidation in China's eastern region. Two years later, Shanghai Auto agreed to buy Nanjing's carmaking business in a government-brokered deal.

One challenge for Rothschild, Yu says, is that the firm doesn't have an equity underwriting business that could help clients raise money to fund acquisitions. The two leaders in Chinese M&A, according to Bloomberg data, state-backed China International Capital and Zurich-based **UBS**, both offer underwriting. Rothschild has been trying to overcome that disadvantage by advising clients on debt structuring and equity raising plans, says Mark Florance, Rothschild's head of Southeast Asia investment banking and a 22-year veteran of the firm.

The China merger market does not generate big fees right now. Chinese companies pay up to 0.7 percent on deals valued above $500 million, compared with 1.2 percent in Western Europe and 1.5 percent in the U.S., according to New York research firm Freeman & Co. Fees on M&A deals in mainland China through May totaled $181 million, compared with $3.1 billion for Western Europe and $4 billion for the U.S., the data show.

That doesn't mean the investments Rothschild is making today won't have a big payoff down the road. "People forget that in the 1980s, the U.S. banks came to Europe and got fewer fees than on Wall Street while building up the necessary infrastructure teams and systems," says Mark Bentley, a former HSBC banker now with SDC Group in London. "Why should China be any different?" To Rothschild, it's not. And it's Yu's ambition to see Rothschild's reputation become as formidable in China as it is in Europe, where the firm made its name financing the Duke of Wellington's campaign against Napoleon. "In 10 years' time, Rothschild in China will become the Rothschild in Europe," she says.

—*Cathy Chan and Jacqueline Simmons*

The bottom line *Rothschild is building up its operations in China and sees the country becoming an increasingly lucrative source of dealmaking fees.*

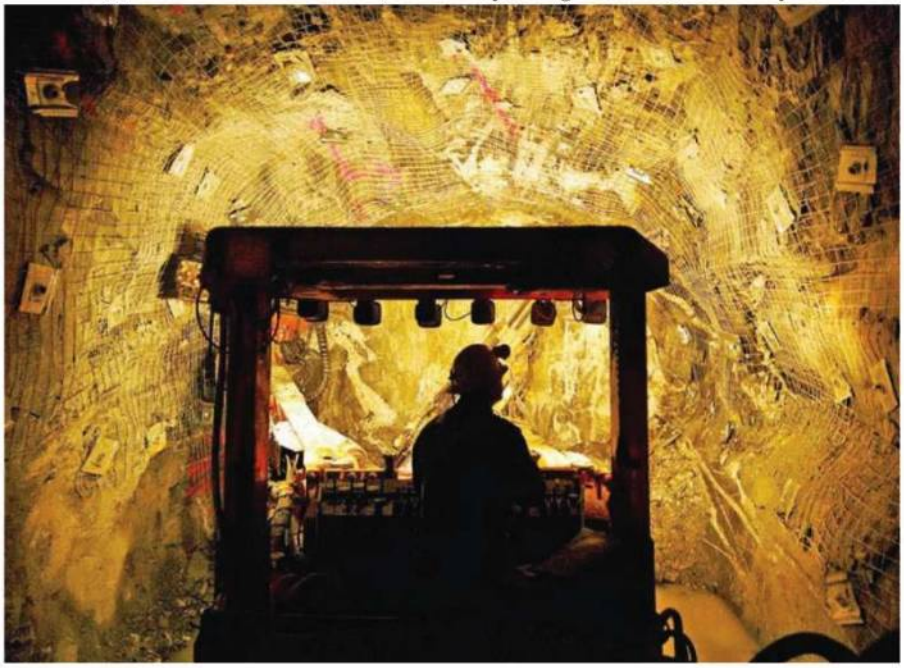
Mergers

It's the Golden Age Of Mining Takeovers

- As new discoveries dwindle, mergers become more attractive
- "There's always a battle of the elephants with gold companies"

A modern-day gold rush is under way as mining companies buy each other at a record pace. **Kinross Gold**'s Aug. 2 purchase of **Red Back Mining** for about $7.1 billion brought the value of gold deals to $32 billion this year, according to data compiled by Bloomberg. That's more than twice the 2009 total. The 260 transactions so far this year account for 38 percent of all mining takeovers by value.

The dealmaking amounts to a bet that the price of gold is headed higher. Bullion hit a record $1,266.50 an ounce in June and is set for a 10th straight annual gain, the longest winning streak since at least 1920. **Bank of America**'s Merrill Lynch unit expects the price to reach $1,500 an ounce by the end of 2011. "If you have a view that the gold price is strong and is going to go higher, then acquiring more reserves or producing properties today makes sense," says Greg Fournier, Merrill Lynch's



Mining mergers amount to a bet that the price of gold will keep going up

CLOCKWISE FROM LEFT: BLOOMBERG; CARL MYDANS/TIME LIFE PICTURES/GETTY IMAGES; IAN O'LEARY/GETTY IMAGES

head of metals and mining investment banking for Asia.

The biggest deal of 2010 has been **KazakhGold Group**'s $11 billion bid to take over its parent, **Polyus Gold**. While elevated valuations and restricted access to loans may reduce the appetite for takeovers in the remainder of the year, the consolidation trend is likely to continue. Gold discoveries have been dropping at a rate of 4 million ounces a year for the past three decades, while demand for the precious metal continues to rise. Companies "are under pressure to continue to buy or find gold to replenish the production pipeline," says Richard Phillips, managing director of **Greenhill Caliburn**. Melbourne-based Greenhill is advising **Lihir Gold**, a Papua New Guinea company that is the target of an $8.9 billion takeover by Australia's **Newcrest Mining**, the second-biggest gold acquisition this year.

China, already the No. 1 gold producer, is on the hunt for new acreage. In an Aug. 3 statement, the country's central bank said it "will place heavy emphasis on supporting large-scale gold producers in their development and overseas expansion" by means of loans and credit lines.

Heavyweights such as **Newmont Mining** of the U.S. and Canada's **Barrick Gold** have also said they are in the market for acquisitions. "It's a real chest-beating industry," says Grant Craighead, managing director of Sydney-based research company Stock Resource. "There's always a battle of the elephants with gold companies. They like to be the biggest." Size matters, of course: Larger firms have an easier time financing deals.

The spike in mining M&A has been a boon for a few banks. **Bank of Montreal**'s BMO Capital Markets remains the leader with nine transactions worth $20 billion, according to Bloomberg data. That's followed by **HSBC** and Merrill Lynch. Merrill's Fournier seems confident that more deals are in the pipeline: The larger players "will continue to be pretty active buying smaller companies, and potentially we'll see some mergers of some of the senior companies at some point in time."
—*Rebecca Keenan*

***The bottom line** Gold prices are headed for a 10-year streak of gains. That has spurred a frenzy of dealmaking as companies try to lock up reserves.*

Bid & Ask

by Cristina Lindblad



Collectibles

Winston Churchill's gold-mounted dentures fetched **$23,750** at auction—more than three times the pre-sale estimate. The British Prime Minister's false teeth were specially designed to disguise a lisp. The buyer was a collector who also owns the microphone Churchill used to announced the end of the war in Europe in 1945.

Power

$9.1bn

Amount an investor group led by Li Ka-shing's Cheung Kong Infrastructure Holdings has offered for EDF's power network in the U.K. The deal is the biggest ever for 82-year-old billionaire Li, who has been called "Superman" by Hong Kong's media because of his investment record. Cheung Kong Infrastructure continues to diversify internationally because it is hemmed in by restrictions in the local power market. Two-thirds of the company's revenues last year came from gas, water, and toll-road operations in Australia, Canada, and the U.K. The transaction is subject to approval by European regulators.

Entertainment

Walt Disney agreed to sell Miramax to Filmyard Holdings for **$660 million**, ending a six-month search for a buyer for the studio. Filmyard is backed by partners including construction executive Ronald Tutor and private equity firm Colony Capital.

Rental Cars

$1.3bn

Value of Avis Budget Group's offer for Dollar Thrifty Automotive Group. Avis' bid tops one from Hertz Global Holdings. One sticking point: Dollar Thrifty wants Avis to agree to a breakup fee, to hedge against the risk that U.S. regulators will nix the deal as anticompetitive.

Commodities

Australia's GrainCorp. is buying compatriot AWB for **$723 million** to create the country's largest agribusiness and top wheat exporter. Asia is now the largest buyer of the grain.



IBM

Debt Markets

IBM raised **$1.5 billion** by selling three-year notes at an interest rate of 1 percent, the lowest on record. Big Blue's bond sale signals that the corporate debt rally that began in June is extending into August. Companies sold $90.1 billion of bonds in the U.S. in July, the biggest total for that month in more than a decade.

Health Care

Outgoing Omnicare CEO Joel Gemunder could walk away with **$133 million** in pension payments, severance, and other compensation. That's one of the biggest exit packages for a U.S. corporate executive. Omnicare sells medication to nursing homes and assisted living facilities.

Mining

Vale is paying $1.1 billion for Brazilian copper producer Paranapanema. Rio de Janeiro-based Vale, which already mines copper in Brazil and Canada, has set a goal of becoming one of the world's top producers of the metal.

verizon



An email from LAX leads to
a video conference with London.
Which leads to a 10% gain
in market share.

Secure, global IT and Communications solutions for better collaboration.

Global collaboration is one reason why the workday has expanded to work always. And partnering with Verizon can help bring together people effectively—so that they develop new ideas, make more informed decisions, and improve your business performance.

Verizon: connecting systems, machines, ideas, and people worldwide for altogether better outcomes. verizon.com/better

©2010 Verizon.

altogetherbetter

Focus On **Jobs**



Help Wanted —For Now

▶ **The jump in temp workers isn't translating into full-time jobs**

▶ **"Companies still don't trust the strength of the recovery"**

As orders for locomotive engines picked up this spring, the **GE Transportation** factory near Erie, Pa., started hiring to fill positions, which had fallen to 4,000 from 5,500 last year. At 18-employee **Pilla Performance Eyewear** in Ridgefield, Conn., business ramped up enough that it expanded its staff by eight. And at medical device maker **Theragenics**, based in Buford, Ga., an unexpected spike in first-quarter orders led the company to add a few dozen workers to its roughly 500-person head count. Finally, U.S. companies are staffing up.

The problem is, many of the positions at those companies, and others like them, have been filled with temporary workers. That's not uncommon in the early stages of an economic recovery; companies, uncertain whether

"You can't bring someone on staff full-time if you don't know that the demand will be there"

increased demand will last, add workers who are more easily hired and fired. This time, though, the growth in temporary positions hasn't been followed by significant hiring for permanent jobs six months later or so, the typical pattern in the U.S. "Temporary workers are just substituting permanent hires, not preceding them, because companies still don't trust the strength or viability of the recovery," says Harm Bandholz, chief U.S. economist at UniCredit in New York. "Recovery is much more fragile when it's based on temporary jobs instead of permanent jobs."

Hiring of temp workers has risen each month since October 2009, according to the Bureau of Labor Statistics. From October to January, employees at staffing agencies like **Manpower** and **Robert Half International** grew at the fastest pace on record—an annualized rate of 51.5 percent, says Bandholz. Private payroll expansion, meanwhile, averaged about 100,000 a month during 2010's first half, "a pace insufficient to reduce the unemployment rate materially," Federal Reserve Chairman Ben Bernanke told lawmakers in July.

Given the depth of the recession and concerns about a double-dip, many companies are seeking more proof of customer demand before doing much permanent hiring. In a robust economy, the acceleration in orders at GE Transportation could have led to hiring full-time workers, says Stephan Koller, the company's spokesman. Proof of sustained demand hasn't yet appeared, however. "The economic recovery has been volatile, and continues to be volatile," says Koller. "If and when that changes, we will respond on the workforce front. You can't bring someone on staff full-time if you don't know that the demand will be there."

Frank Tarallo, chief financial officer of Theragenics, a $40 million company that makes products for the surgical and prostate cancer treatment markets, says that for heavily regulated industries like his, questions about health-care reform and other legislation are layered on to concerns about the economy. "Until there's more certainty about the rules of the game, it's very difficult to plan," he says. "A few years ago we used a few temps, and today we have a significant number. We see a fickleness in the macro economy creating an awful

ILLUSTRATION BY KELLY BLAIR

The Bush tax cuts, all politics aside page 56 ▶



lot of uncertainty for our customers, and it's very difficult to predict their behavior. It makes us very discerning when it comes to adding to full-time head count."

The rise in temp workers could be part of the "new normal" that the recession has produced. Once the economy recovers, American companies may start mimicking European counterparts and use a larger percentage of temporary workers permanently, says Jonas Prising, president for the Americas at Manpower. The recession may have taught them the benefit of being able to quickly hire and fire people to more closely match demand, he adds.

"The economy shifts quicker now," says Daniel Herrick, chief operating officer of Pilla Performance Eyewear, which makes sunglass lenses and frames for athletes. "You need the flexibility in your manpower costs, since sales can fluctuate more." Another aspect of the change, says Theragenics' Tarallo, "is that everyone expects to live in the gray zone much more than they used to have to. It will be a normal part of life for us to have these uncertainties as part of our strategic planning process."

Whatever the case, it's likely to be a long slog to lower unemployment. The jobless rate won't budge from 9.6 percent this year, according to a Bloomberg survey of economists. While growth in gross domestic product of about 3 percent is widely expected for 2010, OppenheimerFunds corporate economist Brian Levitt says it would take at least 4 percent to make a dent in the unemployment rate.

—Esmé E. Deprez and Matt Robinson

The bottom line *More temp jobs once meant more permanent hiring a few months later. With business worried about the recovery, that's not happening.*

6.6

MILLION

People aged 65 and older in the labor force in the first half of 2010, vs. 5.9 million 16- to 19-year-olds. This is the first time since at least 1950 that elderly workers have outnumbered teens.

DATA: LABOR DEPT.

Europe

Norway: Fjords, Oil, And Plenty of Jobs



▶ A flood of stimulus cash has kept unemployment low

▶ "The price for this is that we lose export industries"

The offices of NAV, Norway's national employment agency, may be one of the loneliest places in the country. With Western Europe's lowest jobless rate–3.7 percent, vs. 10 percent in the 16-nation euro zone–Norway simply doesn't have a lot of people looking for work. On a recent Friday, just a dozen or so men and women are on hand at the bright NAV office in the Oslo neighborhood of Frogner. Fred Radenbach, an anthropologist and former pro ping-pong player who has been looking for work for three months, is confident he'll find something soon. While there may be more applicants these days, "There are still jobs," he says as he sifts through listings at a NAV computer.

Prime Minister Jens Stoltenberg was reelected last September after pledging to pursue "employment for all." Norway's energy riches have helped him come close to keeping that promise. Since crude was discovered in Norwegian waters four decades ago, the government has managed to set aside enough oil profits to create a sovereign wealth fund that is now worth some $450 billion. When the economic downturn began, the government was able to create jobs by flooding the economy with cash to fix highways and railroads and for programs such as elder care.

That shielded Norway from the worst of the credit crisis and kept consumer spending alive, but some economists say the program was too lavish. To pay for the $3.6 billion stimulus plan the government last year used 4.8 percent of the sovereign wealth fund, violating a policy guideline that calls for a 4 percent annual cap on spending from the fund. With the stimulus equivalent to 3 percent of gross domestic product, some economists fear Norway could overheat.

The Central Bank frets that Norway's currency may be getting too strong. The krone has risen by 9 percent against the dollar since June. Governor Svein Gjedrem has boosted the benchmark rate to 2 percent from 1.25 percent since October. The government has promised to bring the spending from the wealth fund back below the 4 percent cap, though this year it is expected to withdraw about 5 percent of the fund.

Stoltenberg's goal of low unemployment "is an admirable target, but it comes at a cost," says Petter Haas Brubakk, executive director for industrial affairs at the Confederation of Norwegian Enterprise, which represents 20,000 companies. "The price for this is that we lose export industries" as the krone strengthens, making Norway's goods costlier. His group says the private sector eliminated 34,000 jobs last year even as government bodies added 24,000. With labor costs 58 percent higher than in its trading partners, Norway could see its jobless rate rise to 4 percent next year, the group says.

Norwegians, used to being protected from the economic ills that afflict the rest of Europe, may reject anything that smacks of austerity–and might lower job security. "I don't think they are spending too much money," says Elin Demiraslan, an accountant taking a cigarette break outside her office in central Oslo. "They should spend more on roads, railways, schools, and health care."

—Josiane Kremer, with Jonas Bergman

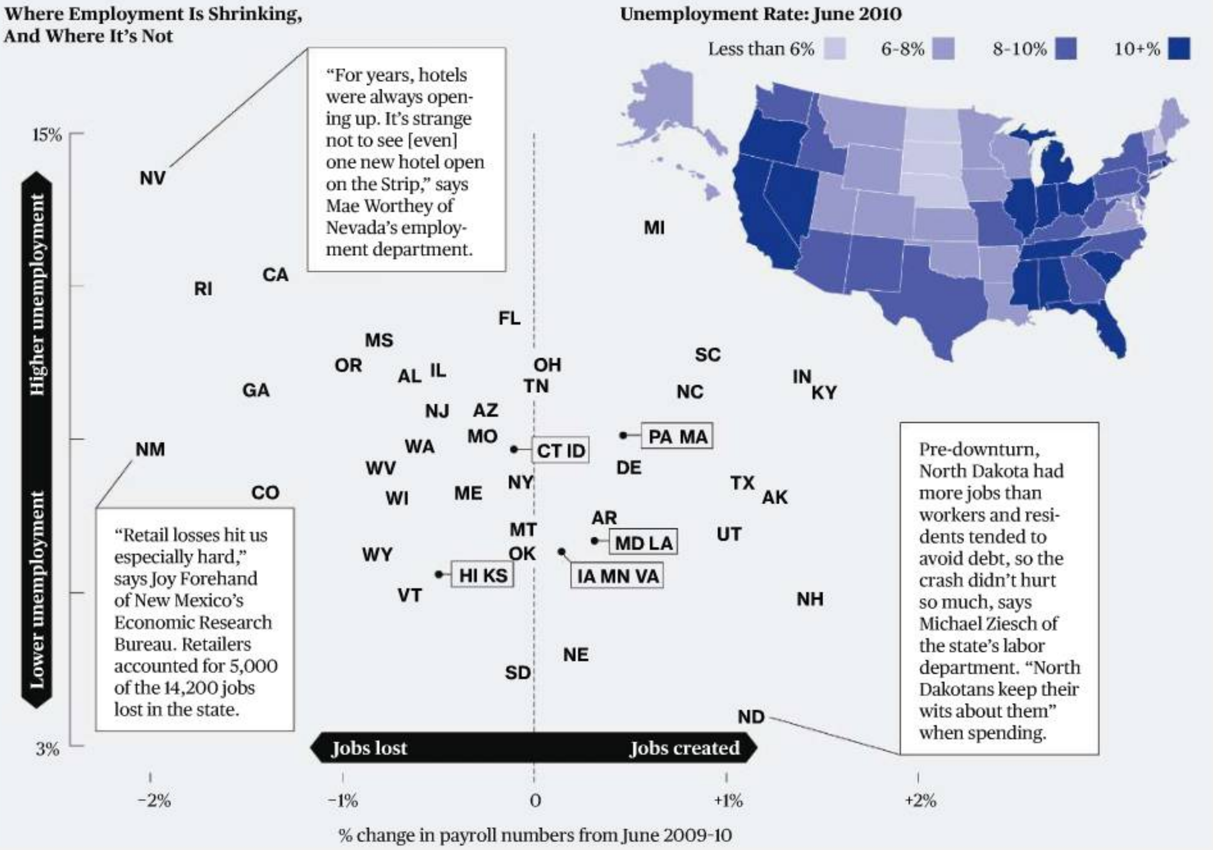
The bottom line *Norway's oil wealth meant the government could protect jobs with a lavish stimulus program. Some economists now fear overheating.*

FROM TOP: CHIP SOMODEVILLA/GETTY IMAGES; TRYGVE BOLSTAD/PANOS PICTURES

Unemployment

The Jobs Picture: A State-By-State Guide

While the economy has started to recover, the jobs outlook remains iffy, with employment falling in 28 states over the past year and rising in 22. —*Matt Robinson*



DATA: U.S. BUREAU OF LABOR STATISTICS

Skills

The Long-Term Jobless Are Being Left Behind

▶ Workers in technology, telecom, and finance are at greatest risk

▶ "Everything after six months just makes it worse"

To understand the potential consequences of long-term unemployment, consider the job prospects of Sheldon Fisher and Douglas Lawson. In January, Fisher, 53, was dismissed from a software company in Washington State. Lawson, 34, lost his job in October with a builder in South Carolina. Now the technology industry is bouncing back while construction remains in the dumps, and Washington's jobless rate is 8.9 percent, vs. South Carolina's 10.7 percent. Lawson's prospects may be better than Fisher's.

That's because being jobless for a long time hurts workers in some industries far more than in others. The technology sector is known for such rapid change that those out of work for even a few months can find themselves with out-of-date skills. Construction skills are far less likely to grow stale. "I never forget what I know. ... I'm not worried about doing the work once I get it," says Lawson, who has applied for about 30 jobs so far. Fisher, by contrast, is considering leaving information technology altogether, though he says he's not sure what else he's qualified to do. After applying for about 100 jobs in his first half-year out of work, Fisher began to worry that employers might think he was getting rusty. "Then everything after six months just makes it worse," he says.

The average duration of unemployment in the U.S. jumped to a record 35.2 weeks in June, up from 16.5 weeks when the recession began in December 2007, according to the Labor Dept. Today, roughly half of unemployed Americans have been out of work for 27 weeks or more (the official definition of long-term unemployment), vs. 30 percent in June 2009.

Industries with highly perish-

Speed Dial

The Long, Hard Road To Job Creation



Christina Romer, chair of the White House Council of Economic Advisors, talks about what needs to happen for the unemployment rate to fall

At 9.5 percent, unemployment is higher than the Administration was expecting. Why is that?
The recession is simply worse than just about anyone was anticipating when we made our first forecast [in January 2009, for unemployment to peak at just under 8 percent]. Also, unemployment has gone up more than you'd have anticipated given the fall in gross domestic product. The relationship between output and unemployment broke down. The unemployment rate jumped a point to a point and a half more than you would expect.

Why do you think that is?
My guess is the main reason has to do with ... the fact that [the recession] was caused by a financial crisis. Since it was such an unusual event, firms may have reacted more forcefully than was usual out of a fear of the unknown. Also, firms that couldn't get credit may have had to lay more people off than normally.

What needs to be done to make it easier for people to find a job?
We need to get demand up. The biggest part of that is going to be the private sector getting its confidence back and people buying things, firms investing.

Our export initiative is designed to try to get some more demand coming from foreign sources. I was a big proponent of a jobs tax credit, such as is in the HIRE Act– if you hire an unemployed worker, you don't pay any payroll taxes [on them] for the rest of this year. That increases demand and gives firms an extra incentive to hire workers.

Is there a point at which you have to say unemployment is not dropping enough, we have to change policies?
The way we've approached policy is to be constantly reevaluating. That's why last year we did Cash for Clunkers, which seemed to be very successful. We did the HIRE Act. We've been proposing more state fiscal relief and have been desperate to get [passage of] the small business lending bill. We're also constantly thinking of what are the things we could do that aren't more tax cuts or more government spending that could accomplish the same goals. Is it a free-trade agreement with Korea? Is it trying to do more commercial diplomacy–making it easier for businesses to export for the first time?

Are there any lessons you can learn from other countries?
Maybe, yes. If you look at which countries [enacted] the biggest fiscal stimulus in 2009 and how they're doing, you see a pretty strong correlation. Countries like China and Australia that did quite strong fiscal stimulus packages are now doing quite well. The U.S., which had a relatively big stimulus, is growing a lot more strongly than many European countries that had much more moderate fiscal packages. —*Mike Dorning*

Focus On Jobs

able skill sets include health-care technology, telecommunications, and finance, where regulations have changed dramatically in the past year. The toughest, though, may be information technology. Companies in that sector have cut payrolls for 32 of the last 33 months, through June, for a cumulative loss of some 312,000 jobs, or about 10 percent. In technology, "if you've been out of work for a year or two, you're probably somewhat outdated," says Shami Khorana, president of **HCL America**, the U.S. arm of New Delhi-based HCL Technologies, which employs about 5,000 workers in the U.S. He plans to hire at least an additional 600 people as the economy improves and anticipates retraining some candidates with obsolete skills.

Unemployed workers in construction, retail, low-level health-care jobs, and teaching are more likely to be attractive to employers once hiring picks up because such jobs don't change as quickly, experts say. "You don't get the sense that residential construction has changed that much in the past decade," says Harry J. Holzer, an economist at Georgetown University and the Urban Institute in Washington. The skills needed to work at a grocery or clothing store–running the cash register, for instance–are "rudimentary," he says.

There are downsides to switching careers, because doing so can push workers into fields where their training isn't valuable, creating a less skilled workforce, says Daniel S. Hamermesh, a former Labor Dept. official who is now an economist at the University of Texas. "It's tremendously difficult [for workers] to decide when the skill is no longer valuable," he says.

When employers start hiring, they'll want to see prospective employees who have done more than pump out résumés trying to find a new job. **Accenture**, for example, will want to see "how the applicants used their time" to stay marketable, says Catherine S. Farley, a Seattle-based managing director at the consulting firm. "Did that person do something to keep their skills fresh?"
—*Timothy R. Homan and Zachary Tracer*

The bottom line *As more workers remain jobless for half a year or longer, they risk losing skills needed to get hired.*

FROM LEFT: JAMES BERGLIE/ZUMA PRESS; ILLUSTRATION BY KELLY BLAIR

John Seely Brown

Focus On Jobs

Picking Passion Over A Steady Paycheck



PHOTOGRAPH ILLUSTRATION BY CREDITTK

More people are leaving behind uninspiring careers and trying to earn a living from work they love. The government can help them reinvent themselves

After more than a decade in the advertising business, Erik Proulx found himself on the wrong end of a pink slip. What most people might have deemed a setback, though, he saw as an opportunity. Instead of looking for another job making TV commercials, Proulx dove into a longtime dream: filmmaking. Last December he released a documentary called *Lemonade*, which chronicles the lives of ad industry veterans who reinvented themselves after being laid off: a coffee roaster, a nutrition coach, an artist, and others who, like Proulx, decided to pursue their passions rather than return to careers that were no longer inspiring.

With the unemployment rate apparently stuck at or near double digits, more people seem to be choosing a passion over a steady paycheck. Rather than waiting for companies to open up their payrolls, these people are taking matters into their own hands and defining their own jobs, going online to find each other, leverage each other's capabilities and services, and learn faster by working together. That is a big risk, but these people realize that they'll be far happier if they can find something they love doing and figure out creative ways to make a living from it. Focusing on work that offers greater meaning makes it easier to withstand the perils and roadblocks they will face as they leave the corporate fold.

The big question is whether this trend can evolve into a sustainable engine of economic growth. I believe two technological developments–cloud computing and social networking–have the potential to make that possible. Cloud computing instantly offers the most powerful technology resources to entrepreneurs wherever they are. Whether you're talking about sophisticated data-crunching capacity or access to scientific devices such as electron microscopes, this technology can now be just a click away.

Social networks and collaboration software help connect entrepreneurs to many more potential partners than ever before. This helps them learn from the experience of others to make their own businesses smarter and more efficient. Until recently, social networks were deeply suspect in the workplace. Now people are beginning to discover that they have growing business potential, especially for smaller entrepreneurs. This is an unprecedented development, allowing entrepreneurs to connect with like-minded individuals around the world, harnessing the power of people to build their businesses.

Social networks and cloud computing make it easier than ever to collaborate with others across the globe

This trend is still at an early stage, but we should focus on what we can do to nurture it. In *The Power of Pull*, a book I co-authored with John Hagel, we argue that simply bringing people back into careers that they are lukewarm about isn't the answer to sustainable job creation. A survey called the Shift Index, released last year by consultancy Deloitte, shows that 80 percent of workers are not enamored of their jobs. In a world of mounting economic pressure driven by intensifying global competition, passion is essential to the kind of performance improvement needed to succeed. Without that, people will be simply exchanging the stress of being unemployed for the stress of feeling trapped in dead-end jobs where ever more effort is needed to just stay put.

Economic downturns are often catalysts for change; rarely do things return to the way they were. This downturn appears to be no exception. As more people turn the stress of unemployment into an opportunity to pursue their passions, the government could support these efforts by, for example, creating tax incentives for entrepreneurs seeking to build businesses in inner cities. This would help create jobs for urban youths, the group with the highest unemployment rate.

Other steps that government could take would be to develop rules that make it easier to hold on to corporate benefits such as health care, shift tax incentives from homeownership to renting to increase worker mobility, and relax licensing barriers that hinder the creation of small businesses. With the right kind of help from policymakers, sustainable job creation just might rest in the hands of the people. Ⓑ

Seely Brown is the former chief scientist of Xerox and former head of the Xerox Palo Alto Research Center (PARC). He is also a visiting scholar at the University of Southern California.



In his first term, George W. Bush promised his tax cuts would

uncontrolled spending, deficits soared. Now most economists



revitalize the economy. But thanks to subpar growth and

say the economy is too weak to let the cuts expire. By Peter Coy

You won't find a truer believer in the big tax cuts of the George W. Bush era than Glenn Hubbard, the lanky, 51-year-old economist who is dean of Columbia Business School. The Republican academic was instrumental in designing the tax cuts, first as a Bush campaign insider and then as the President's first chief economic adviser. The idea behind the cuts, enacted in 2001 and 2003, was to encourage work, savings, and investment, thus stimulating long-term economic growth. Hubbard is especially proud of the 2003 cut in taxes on dividends and capital gains, which he calls "the most pro-growth tax reform that anybody did since Kennedy."

Now that the Bush tax cuts are coming up for renewal—they expire on Dec. 31 unless Congress acts—Hubbard has a queasy feeling about them. The cuts, he says, have been undermined by years of deficits. Until the trajectory of spending changes, he says, "deficits are just future taxes. You're just talking about taxes today vs. taxes tomorrow."

Precisely. The debate over extension of the Bush tax cuts is the opening salvo of a generation-defining fight. With Medicare and Social Security spending set to balloon as baby boomers retire and grow old, the terms of the conflict are crystallizing: What do Americans expect from their government? How much are they entitled to, how much are they willing to contribute—and what are they willing to do without?

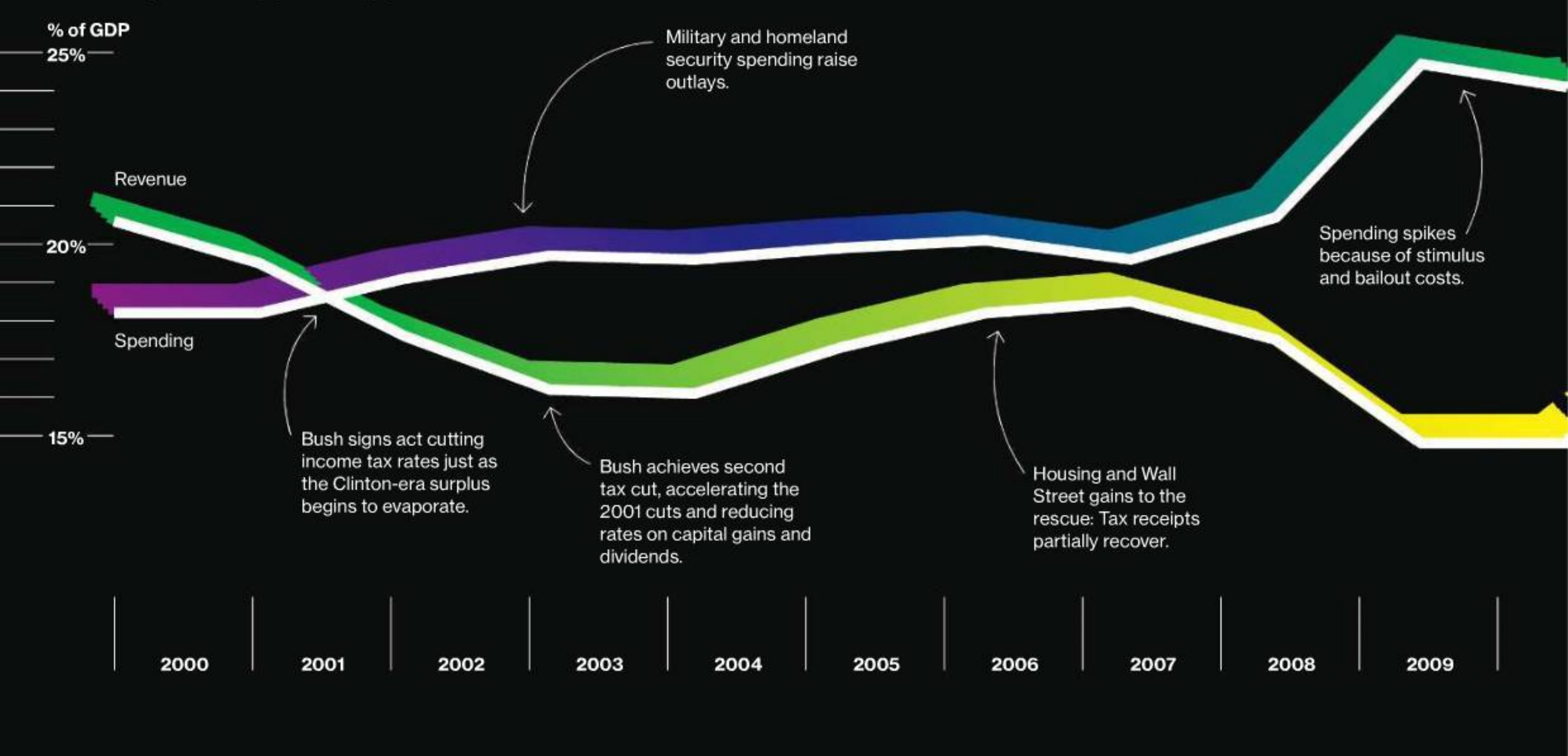
Some people who once championed tax cuts unconditionally have a new catchphrase—or more precisely an old one that's been repurposed: There's no free lunch. Former Federal Reserve Chairman Alan Greenspan, an influential voice in favor of the first Bush tax cut in 2001, told NBC's *Meet the Press* on Aug. 1 that extending the cuts without making offsetting spending reductions could prove "disastrous." Said Greenspan: "I'm very much in favor of tax cuts, but not with borrowed money."

The Bush tax cuts were the product of a rare confluence of political and economic forces we may never see again. They were premised on a sturdy principle: People, both as workers and as investors, respond logically to the incentives that government sets for them. The Economic Growth and Tax Relief Reconciliation Act of 2001 lowered the highest income tax rate (on individuals earning above $200,000 and households above $250,000) from 39.6 percent to 35 percent by 2006 and cut lower brackets' rates by similar amounts—encouraging people to work more by letting them keep more of the fruits of their labor. The 2003 package accelerated the cuts and added the reductions in capital gains and dividends that Hubbard is so proud of because they reward people for saving and investing.

How did the cuts work? The long-planned 2001 tax reduction took effect during the mild 2001 recession and probably helped make it milder, says Joel Slemrod, founding director of the Office of Tax Policy Research at the University of Michigan's Ross School of Business. But the cuts weren't designed as Keynesian energy shots. They were supposed to promote long-term growth by realigning incentives. On that score their legacy is hard to measure because there's no way to know how the economy would have fared without them. Many companies instituted dividends to take advantage of the tax break, but whether that induced more investment is unclear. What's indisputable is that deficits grew while the U.S. economy rumbled along in slow gear: Growth averaged 2.3 percent a year from the end of the 2001 recession through December 2007, at which point the econ-

PREVIOUS PAGE: JONATHAN ERNST/REUTERS/CORBIS

The Bush Tax Cuts: Born of Black Ink, Now Mired in Red



Tax cuts are meaningless without spending cuts, says Glenn Hubbard, co-architect of Bush's tax-cutting plan. "You're just talking about taxes today vs. taxes tomorrow."

omy tumbled into the worst downturn since the Great Depression.

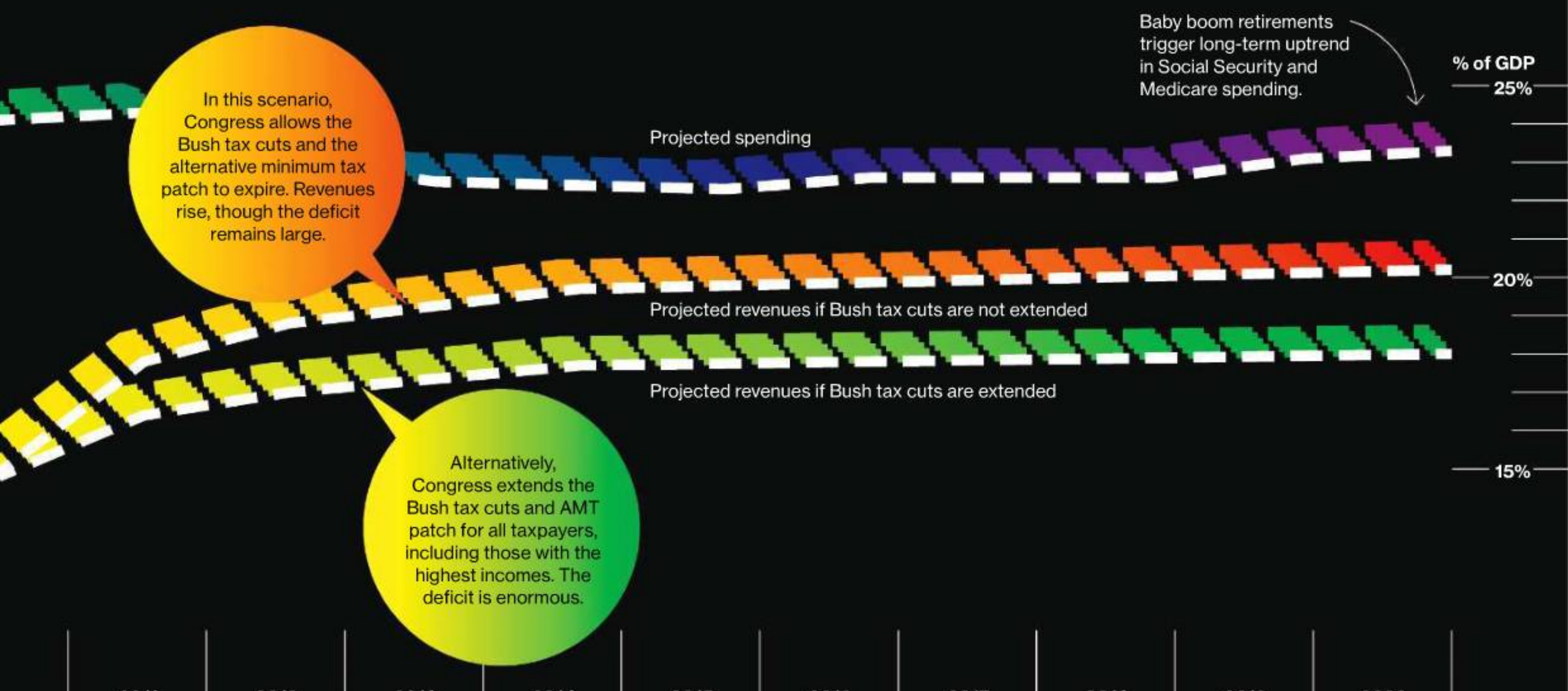
Today, high unemployment is coloring the debate over whether to extend the tax cuts. Democrats who originally opposed them on grounds that they favored the rich are open to continuing them now, figuring that the economy needs all the help it can get. Macroeconomic Advisers, a St. Louis-based economic consulting firm, estimates that a "full sunset" of the Bush tax cuts (and President Barack Obama's modest middle-class tax cut of 2009), as called for by current law, would cut 0.9 percentage points off the growth in gross domestic product next year—a big hit considering that economists surveyed by Bloomberg News expect growth of only 2.9 percent next year.

As a result, the range of options under serious consideration in Washington is remarkably narrow. Republicans want to extend the Bush tax cuts for 100 percent of taxpayers; the Obama Administration wants to limit the extension to a mere 97 percent or 98 percent, excluding individuals earning $200,000 a year or more or families earning $250,000 or more. On Aug. 4, Treasury Secretary Timothy F. Geithner said "the country can't afford" to keep the top-end reductions.

Obama's plan isn't so affordable either. According to the staff of the congressional Joint Economic Committee, the Obama plan would forgo revenue of $2.8 trillion from 2010 through 2020. Protecting high-income taxpayers from the tax-cut expiration as well would cost an additional $700 billion in forgone revenue over the same period, Geithner says.

The cost has economists rummaging for cheaper ways of reviving growth. The nonpartisan Congressional Budget Office ranked continuation of the Bush tax cuts last for effectiveness among stimulus options, partly because rich people tend not to go out and spend their tax cuts. They invest them, blunting the immediate impact. Princeton University economist and *New York Times* columnist Paul Krugman, the unofficial theoretician of the liberal wing of the Democratic Party, said in an e-mail that his preference would be to let the tax cuts expire and replace them with additional aid to state and local governments, which have been forced to lay off workers and curtail social assistance because, unlike the federal government, they are required to balance their budgets. Since, as Krugman says, that's undoable in the current political climate, his second choice is to extend the cuts, as Obama wishes, but only for a limited period.

One problem with extending the cuts is that it doesn't send much of a signal about fiscal fortitude. That's why economist Alan Auerbach of the



DATA: CONGRESSIONAL BUDGET OFFICE, JOINT COMMITTEE ON TAXATION, TREASURY DEPT.

The bill for extending all the Bush tax cuts except the estate and gift tax reductions through 2020: $3.5 trillion.

University of California at Berkeley argues for coupling the extension with a major deficit-reducing measure that would kick in a couple of years from now—say, an increase in the Social Security retirement age. Barry Bosworth, an economist at the Brookings Institution, takes an even harder line. He would let the cuts expire on Dec. 31, stimulus be damned. "We've gotten so deep in the muck that we're going to have to pay the short-run cost" of a hit to growth from rising taxes, says Bosworth.

Congress doesn't see things Bosworth's way because, in part, the bond market isn't forcing it to. The U.S. Treasury is able to borrow for 10 years at an interest rate of just 2.9 percent, vs. 10.2 percent for comparable Greek bonds. Foreign investors, who held 57 percent of U.S. Treasuries at last count, are tolerating minuscule returns because they're confident the U.S. won't default or try to lighten its debt via inflation. The bond vigilantes who terrorized the Clinton Administration into good fiscal behavior have become enablers. Says economist Ed Yardeni, who coined the term bond vigilantes: "This Administration has got to be saying, 'What's all the commotion about? Party on, dude.'"

Party on, that is, until the bond enablers wake up one day and decide that the U.S. has dug itself into a hole it can't get out of. On July 27, the CBO warned of a nightmare scenario in which "investors would lose confidence abruptly and interest rates on government debt would rise sharply." It added: "The exact point at which such a crisis might occur for the U.S. is unknown."

Extending the Bush Tax Cuts:
The Cost from 2010 to 2020*

Income tax cut for families earning less than $250,000 a year	**$1,184 billion**
Income tax cut for families earning $250,000 a year or more	**$700 billion**
Inflation adjustment of the alternative minimum tax**	**$584 billion**
Marriage tax relief	**$360 billion**
$1,000 child tax credit	**$359 billion**
Capital-gains and dividend tax cuts	**$238 billion**
Other	**$71 billion**

*THIS ANALYSIS EXCLUDES THE ESTATE AND GIFT TAX CUTS.
**WITHOUT THIS PATCH, THE AMT WOULD SNATCH BACK THE BUSH CUTS FROM MANY HIGHER-INCOME TAXPAYERS
DATA: JOINT COMMITTEE ON TAXATION, TREASURY DEPT.

Big tax cuts seemed quite reasonable in 1999 and 2000, when Bush was campaigning for his first term as President and talking up cuts to fend off challenges from fellow Republican Steve Forbes and, later, Democrat Al Gore. The U.S. was running budget surpluses and paying down the national debt. It's hard to believe now, but Greenspan, who was running the Fed, worried that if the U.S. paid off all its debts, conducting monetary policy through the purchase and sale of Treasury bonds would be impossible.

On the stump, Bush made an argument with obvious appeal: If the government was taking in more money than it needed, it should let Americans keep more of what they earned. And if tax cuts kept government from growing, so much the better. Hubbard recalls devising the 2001 tax cut in huddles with fellow advisers Lawrence B. Lindsey, who went on to head the National Economic Council, and Hoover Institution scholars John Cogan and John Taylor. So confident was Bush in his tax cut, which he signed that June, that he predicted that even after reducing rates the U.S. would be able to pay off nearly $1 trillion in debt over the coming four years. That August, at his ranch in Crawford, Tex., first-termer Bush called the shrinkage of the surplus "incredibly positive news" because it would create "a fiscal straitjacket for Congress."

What Bush and others failed to see was that the Clinton surplus had been a fluke. Capital-gains tax receipts had grown because of the short-lived dot-com boom. A stalemated government was living within its means: Clinton couldn't get spending programs past the Republican-controlled House and Senate and the GOP couldn't get tax cuts past Clinton. And the vigilantes were vigilant: Investors demanded an inflation-adjusted yield on 10-year Treasuries averaging 2 percent or 3 percent then, vs. less than 1 percent now.

After the 2001 cuts were enacted, deficit hawks such as Clinton Treasury Secretary Robert Rubin grumbled that they were unaffordable, but most of the controversy was over whether the cuts were tilted too much toward top earners, who would get the lion's share of the dollar savings. (The same law cut the estate tax to zero by 2010.)

Then came Bush's second big tax cut, the Jobs and Growth Tax Relief Reconciliation Act of 2003. Once again the biggest debating point was who got the largest share of benefits, not the deficit impact. Quietly, though, deficits were mounting.

Hubbard, who returned to Columbia to become dean in early 2003, was dismayed by the red ink. The Bush tax cuts on investment income were supposed to induce people to invest more, which would stimulate growth, make workers more productive, and ultimately raise wages. But if investors suspected that the move would have to be reversed to cover the growing budget gap, they wouldn't be willing to open their wallets—and the cuts would be of little value. "The spending during the Bush years was a huge problem," says Hubbard, citing the Medicare prescription drug benefit, which is projected to cost $400 billion from 2004 through 2013 and to keep growing.

Indeed, the Heritage Foundation says that spending growth contributed more to the deficits than tax cuts did. Using CBO figures, it calculates that the 2001 and 2003 tax acts were responsible for just (!) $1.7 trillion of the $11.7 trillion swing from projected surpluses to huge deficits from fiscal 2002 through 2011. The other reasons: poorer-than-expected economic growth and stock market performance, $3.8 trillion; higher-than-

In 2001, Bush greeted the shrinkage of the budget surplus as "incredibly positive news" because it would create "a fiscal straitjacket for Congress."

Deficit spending could panic investors, says the Congressional Budget Office. "The exact point at which such a crisis might occur ... is unknown."

expected defense spending, discretionary domestic spending, the Medicare drug benefit, financial bailouts, and other spending, $3.7 trillion; interest costs, $1.4 trillion; the 2009 stimulus, $700 billion; other tax cuts such as the 2008 rebates, $400 billion.

Things get worse from here, though not right away. Over the next few years, deficits will likely shrink as the economy recovers. Then, starting around 2020, the CBO projects that rising health-care and retirement outlays will push the national debt steadily higher despite projected tax increases. In the CBO's more favorable scenario, federal debt held by the public (excluding interagency obligations like the Social Security trust fund) grows from 62 percent of GDP now to 80 percent in 2035. In its unfavorable scenario—so bad that investors would probably revolt before it occurred—debt balloons to 185 percent of GDP.

The political riddle of the moment is how to convince the American people that something's gotta give. They can't have low taxes and high spending and stay solvent all at the same time. Everyone in Washington knows it, yet the courage to act is lacking. Late this year, after the midterm elections, Obama's bipartisan deficit-reduction commission headed by Democrat Erskine Bowles and Republican Alan Simpson will release its ideas. But Obama's political capital has been largely spent on health-care reform and bailouts. It's hard to imagine he will use the last two years of his term banging his head against the brick wall of deficit reduction. Hubbard thinks there won't be any serious action on deficits until the next Presidential term of office—and he wants the Bush cuts to stay in place at least until then. "There's no reason to open up the tax code," he says, "until we're ready to have a real conversation."

Let's hope it turns out to be a conversation and not a shouting match. There's a lot of good thinking on the economics of taxation that could be trampled in the coming political free-for-all. One concept embedded in the Bush policy that deserves to survive is the importance of maintaining low marginal tax rates—i.e., the rates paid on the last dollar of income. Remember, a person in the highest tax bracket, which is now 35 percent, doesn't pay 35 percent of his or her entire income in taxes. Most of the income is taxed at lower rates. Only the last bit earned suffers the biggest haircut. But that last bit matters a lot, because someone who's deciding whether to put in the extra hours and effort to earn an extra $1,000—or whether to kick back in front of the TV instead—will be influenced by the 35 percent marginal rate, not the average rate. Hubbard considers the reduction in the marginal rate on the highest earners, formerly 39.6 percent, to be one of the most growth-inducing aspects of the Bush tax reductions.

Liberal economists like Krugman who favor letting the top-bracket rates rise aren't overly impressed by the marginal-rate argument, saying the disincentives aren't severe enough to discourage people from making the effort. To many Democrats, the focus on lowering tax rates for the rich smacks of trickle-down economics. However, there is a way to preserve the low marginal rates that Hubbard favors while extracting more tax revenue from the well-to-do. That's to shrink the deductions and exemptions that are available to high-income households. Subjecting more of their income to taxes would increase tax payments without higher rates.

Will broadening the income tax base be enough, or is even more drastic action required? Some economists say an income tax, even an improved one, is simply incapable of generating the necessary amount of revenue without rates going so high that they would discourage work, saving, and investing.

One bold idea is to replace the complicated, loophole-riddled income tax with a value-added tax—a sort of national sales tax. The virtue of a value-added tax, widely used in Europe and elsewhere, is that it encourages frugality and saving by taxing spending rather than work and investing. Former Fed Chairman Paul Volcker has advocated consideration of a VAT, as has Senate Budget Committee Chairman Kent Conrad (D-N.D.). Politically, though, the VAT is stuck between tax-hating Republicans like Senator John McCain, who fear it will become an additional tax rather than a substitute, and liberal Democrats, who worry it will fall most heavily on poor people who must spend every dollar they earn (even though a VAT can be designed to protect the poor). In April the Senate voted 85-13 for a nonbinding amendment introduced by McCain that opposed a VAT.

The Bush tax cuts of 2001 and 2003 embodied both wisdom and folly. The wise part was cutting rates in a way that increased incentives to work, save, and invest. The cuts came straight out of the economists' cookbook for achieving stronger economic growth. But setting tax rates without taking spending into consideration was pure folly. Washington lowered taxes while raising spending—an unsustainable combination in the long run.

For business, perpetuating Bush's legacy by extending the tax cuts is highly appealing. Business executives also realize that—no matter what optimistic lawmakers claim—low tax rates can't last if the government continues to spend more than it takes in. "We need certainty. We need to know what those rates are going to be," Daniel Clifton, head of policy research at Strategas Research Partners in Washington, told Bloomberg Radio on Aug. 2.

In June 2001, when the U.S. embarked on the first of the historic Bush tax cuts, the ink was running black and all things seemed possible. Now fear predominates—fear that if the cuts aren't extended, the economy could fall back into recession. In the long run, the U.S. needs a fiscal policy that's based on neither hope nor fear, but on a realistic assessment of what the country needs from its government and what it can afford. B

—With Tom Keene and Ryan J. Donmoyer







Does the CEO Have Any Clothes?

Dov Charney infused American Apparel with his own impulsive, risk-taking persona and turned it into a retail juggernaut. If only he were a little better at math.

By Allison Abell Schwartz
Illustration by Sophie Kern



"Hipster is over"

says Dov Charney, who, as the founder and chief executive officer of American Apparel, rode the trend as far as anyone. Starting the company in a dorm at Tufts University in Medford, Mass., he built a worldwide empire of 280 stores by boldly leaping out ahead of mainstream fashion. Over and over again he remade the hipster wardrobe, sensing the demand for neon nylon bike shorts and lace-thong leotards long before the competition. For better and for worse, he personified the racy, risk-taking aesthetics of his business and is now facing the consequences–skittish lenders and investors who doubt his ability to oversee his own creation. American Apparel shares trade at less than $2, down from a high of $16.80 in December 2007. The company teeters on the verge of being delisted from the New York Stock Exchange Amex because it has been late filing quarterly reports, and last week its accountant, Deloitte & Touche, quit, saying American Apparel's 2009 numbers may not be reliable. The mounting problems suggest the company may now need more sophisticated management than its controversial founder can muster.

Charney, 41, admits the recent troubles have tested him–"It's been a major sweat, a real hard job"–but insists he will stick it out and that there will be no dialing back of ambition. His plan is to plunge straight into the storm, doubling the sales of the 11,500-employee company over the next six years by improving productivity and implementing better technology to more quickly move product from the company's Los Angeles factory into stores. Down the road, American Apparel, which owns and operates its own stores, might also sell its products through other retailers.

The biggest challenge of all may be stylistic. After outfitting the world of 18- to 30-year-olds in all manner of T-shirts and leggings, which still rank among the company's best-sellers, American Apparel is going preppy, diving into more sophisticated garments such as blazers, pleated pants, button-down shirts, and more formal lace tops. "Kids are moving away from piercings," Charney says. "We want to grow old with our customer. We want to be a traditional American clothier."

Even as American Apparel has grown, Charney, who owns 53 percent of the company and dresses exclusively in his own product, down to socks and underwear, has kept management small and personal. He makes it a priority to walk through his factory most days, talking to employees, handling fabrics, and seeing garments being made, a process he says takes more than two hours of his day. His mobile number is available to all employees, he says, and he prides himself on returning all calls. He spends much of his time with a circle of about 15 people who help him look at fabric and evaluate new designs.

Lately, though, the business is much less about fabric than finance. The NYSE Amex threat to delist American Apparel could become reality if it fails to file its most recent quarterly report by Aug. 16, the second delay in little more than a year. The delay stemmed from renegotiations on its second-lien loan with Lion Capital. That has since been settled, but another problem burst into public view when Deloitte notified American Apparel that certain information had come to its attention, that, if investigated, could impact the reliability of the company's 2009 financial statements. Charney says he's confident the accounting issues will be straightened out by the deadline.

Lion Capital, a London-based private equity firm, agreed in March 2009 to loan American Apparel $80 million maturing Dec. 31, 2013. As part of the agreement, Lion received detachable warrants amounting to 16 million shares of the company's common stock, equal to about 18 percent ownership.

Charney prematurely told investors on a conference call that the company had reached a new agreement with Lion, which was followed by a press release from American Apparel admitting it was at risk of breaching loan covenants. The two parties came to an agreement last month requiring American Apparel to meet trailing 12-month profit targets. The agreement would also raise the loan's interest rate by 2 percentage points, to 17 percent, if certain debt-to-earnings ratios aren't met, according to a regulatory filing.

Before the financial problems intensified, Charney had been contending with damaging sexual harassment allegations followed by a devastating immigration bust. Fifteen-hundred workers at the Los Angeles factory had to be let go owing to lack of documentation and another 1,000 quit for fear of being swept up for immigration violations. For a company that is proud of its insistence on domestic manufacturing, it was a costly blow. The recession has also taken a toll; the company posted same-store sales declines from February to December of 2009 and has not reported comparable store sales results since then.

"Those are troubling issues for the board and for the investors in the company," says Charles M. Elson, a University of Delaware professor who specializes in corporate governance. "It raises questions about controls within the company. It raises questions about the efficacy of oversight."

Yet American Apparel is not without admirers. Edward Yruma, an analyst at KeyBanc Capital Markets in New York, calls the brand "edgy and provocative." And Charney says all the controversy won't stand in his way. "That stuff's not going to matter," he says. "In the end that will all dissipate, because scandals disappear faster than you think."

Charney, who grew up in Montreal, started selling Hanes T-shirts in his last year of boarding school at Choate Rosemary Hall in Connecticut in 1986. He'd buy them at bulk prices in the U.S. and sell them for a profit in Canada. At 17 he was arrested for selling T-shirts at a Madonna concert in Montreal, and his dad had to go to court on his behalf because he was back at Choate. He ended up being fined C$25.

Charney started American Apparel in his freshman year at Tufts and got so absorbed in it that he never graduated. He got in his car one night to drive to South Carolina and never went back. In 1987, Charney manufactured a few thousand T-shirts in Ninety Six, S.C., employing 20 women who worked in a

"Would the company have survived if we hadn't opened 100 stores in our first three years? Would we have captured the imagination of the public? Would it have been big enough to have been noticed?"

American Apparel grows up



barn with no air conditioning. Ten years later he moved the company to Los Angeles, where there was greater manufacturing capacity.

In 2003, riding in a taxi in Manhattan, Charney saw a retail space for rent and had an epiphany about where he could take his business. He promptly opened three stores—in New York, Los Angeles, and Montreal—and by 2006 he had 100 more. "Everybody along the journey thought I was crazy," he says.

Since it went public in 2007 through a special-purpose acquisition company, Endeavor Acquisition, American Apparel has doubled its store base, to more than 280 in 20 countries, a rate of expansion that has concerned some analysts. "They have overexpanded in recent years and had assumed that their past demand growth would continue at its earlier torrid pace, which it hasn't," says Craig Johnson, president of Customer Growth Partners, a consulting firm in New Canaan, Conn. "What was once a fresh new look is now seen by many as neither as fresh nor as new."

Charney says the rapid expansion was necessary to boost awareness of the brand. "Maybe there were a dozen stores we shouldn't have opened," he says. "Maybe we could have structured things differently, but then if it wasn't all about expansion, would we be a brand of any importance? Would the company have survived if we hadn't opened 100 stores in our first three years? Would we have captured the imagination of the public? Would it have been big enough to have been noticed?"

Moving too quickly isn't the only knock against Charney. He has been sued by three former employees for sexual harassment (one suit was dismissed, one was settled, and a third remains in arbitration), and in 2004, *Jane* magazine reported that he masturbated in front of a reporter while being interviewed. More recently, Gawker.com reported that American Apparel makes managers photograph its female store employees so Charney can ensure they fit his aesthetic tastes, which include full eyebrows and long, natural hair. Charney says there is no official doctrine, and that they look for people who understand the brand, know how to present themselves, and can communicate the brand's style to its customers. Still, Charney's record makes some wonder whether he has the judgment and credibility to oversee a large company. "The travails of their senior management, all well-known, will make fixing the brand very difficult until a management change occurs," says Johnson of Customer Growth Partners.

Charney insists he is willing to make major changes to how the company is managed, including the possibility of hiring three chief operating officers to run manufacturing, distribution, and retail separately. The company has recently added new senior staff and will continue to make key appointments, including a director of quality control, Charney says. He also says he is open to relinquishing his CEO role when he has built a management team he feels confident can take over. Charney does have his supporters, including Yruma, who praises his "hands-on" management style. Allan Mayer, who has served on American Apparel's board since 2007, calls Charney a brilliant marketer with an incredible work ethic. "This is a guy who works seven days a week, 52 weeks a year," says Mayer, a partner at Los Angeles public-relations firm 42West. "You don't build a $600 million-a-year vertically integrated manufacturing and retailing business on an edgy image and sexy ads alone."

Charney admits there are things he could have done differently: not opening quite as many stores; taking the company public through a normal initial public offering instead of through a shell company; moving manufacturing offshore while he resolved his worker problems.

"A lot of assumptions that I grew up with are no longer reality," he says. "Those were things that we could rely on: that lenders will always be there, that they'll behave ethically and they'll always have money, that you can trust that as the sun comes up the consumer will be healthy, that we'll always be close to full employment in developed nations. Now there are no certainties."

George Whalin, president of Retail Management Consultants in Carlsbad, Calif., says the brand is strong but the company needs a management overhaul. "Volatile people running retail businesses are scary people," Whalin says in an interview. "But I think [American Apparel's] concept is still viable."

That concept, however, is in flux. As Charney reorients the company to more grown-up styles, he goes up against the likes of J.Crew, Gap, and even Brooks Brothers, retailers who have been cultivating the preppy look for years. Charney says he isn't worried because his clothes are basics without the frills, and that nobody else can serve that market as well as he can.

As for his other troubles, Charney says he is used to people underestimating him, recalling a loan officer at the Bank of Nova Scotia who waffled about extending a line of credit back when American Apparel was making $1 million a year. The hipster may be dead, but Charney lives on. "Over time, I will improve my ability to perform," he says. "Keep watching the movie and I'll prove you wrong." B

What's This Degree Worth?



Art Institute of Fort Lauderdale graduate Carrianne Howard started stripping after she couldn't find a job; "It's like I didn't attend school at all."

Goldman Sachs made millions through its stake in EDMC, whose schools peddle arts degrees costing up to $100,000. Some debt-crippled students are crying foul

By John Hechinger
Photograph by Misty Keasler

Carrianne Howard dreamed of designing video games, so she enrolled in a program at the Art Institute of Fort Lauderdale, a for-profit college part-owned by Goldman Sachs. Her bachelor's degree in game art and design cost $70,000 in tuition and fees. After she graduated in December 2007, she found a job that paid $12 an hour recruiting employees for video game companies. She lost that job a year later when her department was shuttered.

These days, Howard, 26, makes her living in a way that doesn't require a college diploma: by stripping at the Lido Cabaret, a topless club in Cocoa Beach, Fla. "I didn't know what else to do," she says. "I've got a worthless degree. It's like I didn't attend school at all."

Like many investors, Goldman, owner of 38 percent of the Art Institute's parent, Education Management Corp., was drawn to for-profit colleges by their rapid growth and soaring stock prices. Now Goldman, which recently agreed to pay $550 million to settle U.S. civil-fraud charges related to the subprime mortgage meltdown, is invested in an industry under attack from Congress, the Obama Administration, and dissatisfied students. This week the Senate held a hearing featuring a Government Accountability Office undercover probe that found recruiters at EDMC's Argosy University in Chicago and 14 other for-profit colleges misled investigators posing as potential students about the cost and quality of their programs. Near their peak in April, Goldman's shares in EDMC were worth $1.39 billion. Since then they've fallen by 42 percent, to about $800 million.

A proposed government crackdown could have a disproportionate effect on EDMC. The U.S. Education Dept. could restrict taxpayer-funded grants and loans to for-profit colleges like EDMC that offer $50,000 associate's and $100,000 bachelor's degrees in such low-paying fields as cooking, art, and design.

Until recently the education business looked like a bonanza for Goldman. Pittsburgh-based EDMC, the second-largest U.S. chain of for-profit colleges after Apollo Group's University of Phoenix, has 136,000 students—more than three times as many as the University of Michigan. Its annual revenue doubled over the last five years, to $2.4 billion. Goldman and two other firms bought EDMC in 2006 and took it public in 2009. Along the way they shared at least $70 million in advisory, management, and other fees, according to securities filings. Goldman also became EDMC's biggest stockholder.

Government grants and loans to students, combined with booming enrollment, have made for-profit colleges a rewarding investment. Federal aid to for-profit colleges jumped to $26.5 billion in 2009 from $4.6 billion in 2000, according to the Education Dept. EDMC currently receives almost 82 percent of its revenue from federal financial aid programs.

On July 23, the Obama Administration proposed restricting—and in extreme cases, cutting off entirely—programs whose graduates end up with the highest debts relative to their salaries and have the most trouble repaying their student loans. EDMC will be affected more than most other for-profit companies because of its focus on "passion" fields, such as art and cooking, rather than more practical accounting or business degrees, says Jeffrey M. Silber, an analyst with BMO Capital Markets in New York. Cooking, fashion, and arts jobs tend to have low starting salaries: A beginning cook, for example, earns an average of $18,000 a year, according to U.S. Bureau of Labor Statistics data, while a two-year culinary degree can cost $40,000 to $50,000. EDMC spokeswoman Jacquelyn P. Muller says Art Institute students tend to earn more, with those holding culinary degrees starting at $28,000.

EDMC also faces complaints from its own graduates and employees. A lawsuit filed in Texas state court by 18 students alleges they were misled about the accreditation status of their program, diminishing their degrees' value and leaving them with debts they can't repay. In another suit a former admissions officer claims the company engaged in high-pressure sales tactics, paying staff to sign up students. In July, dozens of faculty who tried, unsuccessfully, to form a union at one Art Institute campus complained that unqualified students were being let into their classes.

Goldman spokeswoman Andrea Raphael said in a statement that the company invested in EDMC "because of its leading position in the private higher-education space, its successful track record, and its demonstrated commitment to its students." She referred other questions to EDMC, which said that the student complaints don't reflect the quality of EDMC's academic programs or the success of its graduates. EDMC says it takes seriously any alleged shortcomings uncovered by the GAO. Declining to discuss individual students, EDMC denies the allegations in the lawsuits.

"The vast majority of our students" are "satisfied with their experience and go on to successful careers after graduation," Muller said in a statement. She also said EDMC's chain of institutes has illustrious alumni, including tennis star Venus Williams, who graduated with a fashion design degree from Fort Lauderdale in December 2007, on the same day as Howard; Logan Neitzel, a 2005 graduate of the Art Institute of Seattle and a 2009 contestant on television's *Project Runway*; and Carol Guzy, a 1980 graduate from Fort Lauderdale who is now a Pulitzer Prize-winning photographer at *The Washington Post*.

Over the last two years, Muller says, students have found work at companies such as Electronic Arts, Neiman Marcus, and Sony. The company cites students such as David Suppe, who graduated in 2005 from the Art Institute of Las Vegas and now works as a chef at the MGM Resorts International's Excalibur Hotel. "I got so much out of my education," says Suppe, 41. "I never would have advanced in this career without it."

As evidence that EDMC's students are succeeding, Muller notes that the company's latest government student-loan default rate–which measures loans that go bust in the first two years students owe money–is 7.5 percent, vs. an average of almost 12 percent at all for-profit schools. EDMC's rate is twice that of four-year nonprofit universities–though many graduates of traditional schools find themselves with heavy debts and low-paying jobs as well.

Like some of its students, EDMC has substantial debt. In 2006, Goldman Sachs, Providence Equity Partners, and Leeds Equity Partners borrowed $2 billion when the group purchased the company for $3.4 billion, taking it private in a leveraged buyout. Goldman, which made the investment through GS Capital Partners, a private-equity fund that uses money from Goldman and outside clients, took EDMC public again last October. The company has reduced its debt to $1.53 billion.

The debt from the acquisition changed the culture of EDMC, according to Robert T. McDowell, who retired as EDMC's chief financial officer shortly after the buyout. Before the acquisition, McDowell says he and other executives resisted calls from Wall Street analysts to pursue growth opportunities that could undermine academic quality. "You take on that amount of private-equity debt, you need to earn high rates of return for these investors," says McDowell, who worked at the company for 18 years. "I was worried that the quality of the experience for employees and students was going to deteriorate."

Muller says the borrowing hasn't hurt employees, faculty, students, or programs. EDMC has invested more than $1 billion in campus buildings, technology, and other capital projects over the last 10 years–more than half over the last four years, she says.

At the New England Institute of Art in Brookline, Mass., administrators show off classes averaging 16 students using new computers and the latest software in the animation program. The school has a $500,000 sound studio, a 14,000-volume library, and a student-run art gallery.

In its promotional materials, EDMC highlights graduates such as Jonathan Lukason, who received his bachelor's in audio and media technology in 2008 from New England and has worked as a freelance audio engineer for NBC and ESPN. In an interview, Lukason calls the institute's program "the best one around." Still, Lukason complains, he earned $25,000 in his first year out of school, and he is struggling with $55,000 in student loans. "At this rate, I'll be dead before I pay it off," he says.

To sell students on degrees, EDMC deemphasized their costs and offered sales incentives to employees for signing up prospects, says Brian Buchanan, a former admissions officer whose lawsuit against EDMC was unsealed in May. Top producers won spots in the "President Club," which entitled them to trips to foreign beach resorts, gift cards, and iPods, according to Buchanan's suit, which was filed in 2007 in U.S. District Court in Pittsburgh. Buchanan, a former waiter, worked as an admissions representative for EDMC's South University online from December 2005 until May 2007.

In an interview, Buchanan said EDMC gave admissions staff a matrix showing



"There's something for everyone at the Art Institute of Fort Lauderdale," says the college's website

"I'll be working the rest of my life to pay off these student loans," says Stephanie Capalbo, who earned a psychology degree at EDMC's Argosy University. "It's an unbearable debt."

them how much money they would make for each enrollment. Generally, each student was worth $800, he said. To recruit students, EDMC told employees to use the "bring the pain" sales tactic, according to his lawsuit. For example, a single mother would be told, "How are you going to explain to your children that you cannot buy them the things they need because you couldn't be bothered to finish your education?" the complaint says. Buchanan's case is a whistle-blower suit that seeks to recover damages on behalf of the federal government with the plaintiff keeping a share. In a Securities & Exchange Commission filing, EDMC said the claims are "without merit."

In July, instructors at the Art Institute of Seattle raised questions about EDMC when they tried to join the American Federation of Teachers. The union lost in a 48 to 64 vote. Instructors objected to high-pressure marketing to students to take out loans they couldn't afford, says Sandra Schroeder, president of the AFT in Washington State. The institute encourages faculty to give passing grades to students who aren't making progress, she says, so the school can keep collecting federal aid money. EDMC administrators take the allegations seriously and "respect and promote the principles of academic freedom without fear of repercussion or interference," Muller says.

Students also object to EDMC practices. Argosy University in Dallas falsely told applicants to the clinical psychology doctoral program that the institution would get accredited by the American Psychological Assn., 18 former students claim in a lawsuit filed in Dallas County District Court last year. Stephanie Capalbo, one plaintiff, moved from suburban New York City to go to the Texas university. In an interview, Capalbo, who got her doctorate in 2008, says officials told her the school was in the process of getting accreditation, which it still hasn't achieved. Capalbo says she now owes about $130,000 in government loans for Argosy tuition and fees and another $150,000 in private loans for living expenses. Her payments are $1,500 a month, draining the $60,000 the 29-year-old makes each year working for a nonprofit that evaluates children for foster care in New York. Many employers turned her down for higher-paying jobs because she lacks a degree with APA accreditation, she says. "I love being a psychologist, but I have a family," she says. "I'll be working the rest of my life to pay off these student loans. It's an unbearable debt."

EDMC spokeswoman Muller says the allegations in the lawsuit against Argosy are "unfounded" and that APA accreditation isn't required for graduates to become licensed as clinical psychologists in most jurisdictions, including Texas. Argosy hasn't submitted an application to the APA and continues to prepare for the accreditation process, which takes time because of the data required, Muller says. She adds that colleges can't control the amount of debt that a student takes on.

Carrianne Howard, the Florida student, didn't borrow for her education. Instead her parents paid roughly $70,000 in tuition bills. Her mother, an airline data analyst, and her father, a computer engineer, sold their California home and moved to Virginia after her father lost his job and her mother retired. They used money from the sale to pay for tuition, and her parents are now struggling financially, Howard and her mother say.

Howard grew up in Valencia, Calif., a suburb of Los Angeles, and became drawn to video gaming during high school. One afternoon in 2004, an Art Institute ad popped up on her PC. "I was as excited as can be," she says. "I thought it was a dream come true." She and her mother toured the Fort Lauderdale campus, a bright, modern three-story building flanked by reflecting pools and palm trees. Her tour guide "just made it sound really exciting and a lot of fun, like I was going to make hundreds of thousands of dollars," Howard says. EDMC schools train representatives to make "no promise, implication, or guarantee" about employment, Muller says.

A couple of years into her studies, Howard says she grew disenchanted. Some classes consisted largely of playing video games, she says. She wanted to drop out but her mother insisted she finish because the family had spent so much already. She graduated in December 2007; in March 2009 she lost her first job, at GameRecruiter, a Fort Lauderdale-based gaming industry employment agency where she was making $12 an hour. Marc Mencher, GameRecruiter's president and CEO, says she was let go only because he closed down her entire department, and calls her "an exceptional performer."

She may be struggling to find work in part because of inadequate preparation from the Art Institute's gaming department, Mencher says. "It's a weak program because it's understaffed," says Mencher, who serves on the Art Institute's national advisory board for gaming programs. "I personally feel the students aren't getting their money's worth." After *Bloomberg Businessweek* asked EDMC for comment, Mencher sent a follow-up e-mail, saying that although the Art Institute is "not perfect and they have issues like any organization," it is "an excellent program built on input from respected industry professionals along with local employers." It has an "outstanding placement" record for graduates, he said.

Howard applied for dozens of jobs, not only in gaming but also in grocery stores and nursing homes, mostly for minimum wage, she says. In October 2009, Howard turned to adult entertainment by doing paid Web chats. In March she started dancing at Lido Cabaret, earning $400 to $1,000 a week, she says.

She now hopes to save enough to go back to college and get a business degree. As she considers returning to school, Howard also helps run an anti-Art Institute website, where she has collected more than 70 names in a petition to send to the U.S. Education Dept.

The private, nonprofit Florida Institute of Technology, where Howard would like to enroll, won't accept any of her credits from EDMC, according to spokeswoman Karen Rhine, because the Art Institute doesn't have the kind of accreditation the traditional college requires. In its school catalog and other documents, the Art Institute "does not imply or guarantee" that credits will transfer to other universities, says EDMC's Muller.

At 1 a.m. on a recent weeknight, Howard finished a shift at Lido. "This is what I do," she says. "When I'm in here, I try not to think about the Art Institute." Ⓑ



How To Surv

Gary Loveman left a Harvard Business School professorship to join Harrah's Entertainment. By putting his theories about customer service into practice, he built the world's biggest gaming company. Then came the crash

By Karl Taro Greenfeld
Illustration by ilovedust

ive in Vegas



Gary Loveman, the chief executive officer of Harrah's Entertainment, the largest gaming corporation in the world, sees his customers as a set of probabilities wrapped in human flesh. First he considers the most basic set of probabilities, gender and age, since females are more regular gamblers than males and older women are the most lucrative demographic of all. Then he factors in where we live, what we do, how much we make, and, most important, how we wager and what we play when we come to one of his casinos. From those details, Loveman can divine to a remarkably accurate degree how much you, or the set of probabilities you represent, will be worth to Harrah's over the course of your lifetime. "I am purely empirical," says Loveman, sounding like the former Harvard Business School professor he is. "I am not attached to any romantic notion of how this business should be run. I am only driven where the evidence takes me."

Loveman is a unique figure in American business: an academic theoretician who made the transition to operating a multibillion dollar corporation. Uncommon career path aside, he's not much of a gambler. He sees the floor at Caesars Palace as his storefront, and the people at the craps and blackjack and roulette tables and at his beloved slot machines—those computerized boxes that pay out less than craps tables and gather so much more information—as the customers Harrah's must strive to please. The happier they are, the more pleasant their experience at one of Harrah's 52 casinos, then the more likely the set of probabilities embodied in each of them will continue to pay out for Loveman. When you look out at a casino floor, you see people playing blackjack or the slots; when Gary Loveman looks out at that floor, he sees his slots or his table games playing you.

"Mathematics is the language of logical expression," he says, "and my mind works very logically. I have found in the casino business that is a great help most of the time." Since taking over as CEO in 2003, Loveman, 50, has relied on the numbers to build Harrah's from a regional operator of 15 casinos to one with 39 in the U.S. and 13 more overseas. He snapped up properties during the boom years, buying the World Series of Poker and three casinos from Binion's Horseshoe for $1.5 billion in 2004, Caesars Entertainment for $9.3 billion in 2005, and the Imperial Palace in Las Vegas for $370 million later that year. In 2007 he spent $600 million to acquire a golf course in Macau—the largest piece of land in the fastest-growing, most lucrative gaming market on the planet, according to the American Gaming Assn. (AGA). Late last year he bought the Planet Hollywood Resort & Casino in Vegas, once worth $1 billion, for just $70 million and the assumption of $550 million in debt. These were what Loveman calls "high-probability" purchases; each acquisition (except for Macau) provided immediate revenue growth as Harrah's Entertainment emerged as the largest owner of real estate on the Las Vegas Strip. (In October, Harrah's plans to change its name to Caesars Entertainment.) "My sort of logic excels at things like acquisitions or expansions or developments," he says, "where I can look at the numbers and make it a defined, deductive problem."

The numbers also compelled Loveman to reject the traditional Vegas business model of spending billions to build bigger, more lavish "slot boxes," as he calls the opulent casinos that dominate the strip. They tend to produce fantastic revenue their first year or so; after that, their performance steadily deteriorates as "other, better boxes are built." Instead, Loveman concentrated on building loyalty among Harrah's customers. Before he got to Vegas, casino marketing meant spending big money to lure "whales," industry parlance for extremely wealthy gamblers, to town. Loveman went broader, compiling a vast customer database and sending targeted offers and come-back-soon inducements to millions of people with the desired probabilities. The program has driven gaming revenue—far more profitable than food or hospitality—to 80 percent of Harrah's $9 billion business, vs. an industry average of 45 percent, according to the AGA.

Harrah's shareholders profited from Loveman's numeric mastery in 2008, when private equity firms Apollo Management and TPG Capital took Harrah's private for $30.7 billion, the last big leveraged buyout of the pre-crash era; stockholders took home $90 a share as Loveman and his new partners increased Harrah's debt load to $24 billion. (Apollo and TPG didn't fare as well. Their deal valued Harrah's equity at $17.1 billion; today it is valued at $7.2 billion, according to data compiled by Bloomberg.)

Loveman's way with the numbers, he admits, can also be a weakness. It was responsible for the worst decision he has made as CEO, a mistake he's been trying to rectify for the past four years: his 2006 refusal to bid on a $900 million gambling concession—and one of just six gaming licenses—in Macau. (He bought the golf course a year later in a belated attempt to get in on the action.) "The quantification on Macau took me in the opposite direction," he concedes. "You had to have a kind of intuitive courage and I am not well suited to those kinds of decisions." Because he passed on the deal, Harrah's is for now locked out of the industry's most important emerging market. "Big mistake. I was wrong, I was really wrong."

Missing Out on Macau

Harrah's, and Loveman, are still paying the price. As Vegas has swooned, Macau has boomed to the point where competitors such as Las Vegas Sands and Wynn Resorts are now making more revenue in the coastal Chinese city than they do in Vegas. As rival CEOs Steve Wynn and Sheldon Adelson of the Sands made the decision to pile into Macau, the numbers told Loveman to stay out. "I try to be self-reflective of the fact that this is a short-coming of mine," he says. "I am trying to address that vulnerability by asking myself over and over again if I am overthinking the problem. Am I missing something?"

Loveman is sitting in his office on the second floor of the Palace Tower at Caesars—just upstairs from the counter where they give out the towels for the Garden of the Gods Pool Oasis. It's a vast rectangle decorated with wood panels, overstuffed chairs with beige stripes, and a maple bookcase with a signed Super Bowl XXXV helmet, models of Harrah's fleet of jets, and photos of Loveman with various notables. The decor is C-suite Modern—Loveman can't say who did the tropical-themed painting of a veranda and garden that hangs on the wall. "Reggie?" He shouts to his assistant. "Who is responsible for the painting above my desk?" She blames the design firm.

He is a large man—6 foot 1, roughly 250 pounds, and "uncomfortable in the gym," as he says—with brown hair, square face, large jowls, no neck. He dresses simply; on an early summer day—108 in the shade—he's wearing black shoes, grey slacks with a white pin stripe, a blue shirt, and an orange tie. He speaks in a gravelly voice and a steady, Al Gore-like drone of impeccable diction and complete sentences. When it comes to interviews, he has certain ground rules. His family is off-limits.

"There are three reasons for this," says Loveman, who lives with his wife in a suburb of Boston, has three children

PHOTOGRAPH BY MICHAEL EDWARDS FOR BLOOMBERG BUSINESSWEEK



Loveman engineered a leveraged buyout just before the crash. "One wouldn't choose to do this in advance of a consumer spending collapse," he says

in college, and flies home from Vegas on weekends in a corporate jet. "One, I have 80,000 some-odd people working for me here and a small number of them are likely to be unhappy with me for some reason—we've laid off their wife, they've lost their health benefits, something. The second is that we are in the middle of a long and unpleasant negotiation with the UAW over unionizing one of our Atlantic City operations. And the third is there are a number of people who think gambling is the devil's work and that I am a consummate devil because I am a smart devil." Gaming CEOs are known to take extreme security precautions, in part because one never knows the intentions of those who, as Loveman puts it, "may have an adverse result at the casino." If a bundle of probabilities goes postal, he doesn't want to be there for it.

Vegas Before the Fall

The last time I visited Las Vegas, in May of 2007, the U.S. economy was booming, shrugging off the first waves of the housing crisis, and Bear Stearns was still a going concern. It was the weekend of the Oscar De La Hoya/Floyd Mayweather junior middleweight title bout, then the highest-grossing fight in boxing history, and everything in town—a room, taxi, table—required waiting in line. The nation's wealth was everywhere on display, and every casino was jammed. The skyline itself was rapidly transforming, as huge construction projects—$55 billion worth of mostly junk-bond-financed "slot boxes"—promised to give gaming executives even more opportunities to cash in on favorable probabilities.

The casinos were then so flush that deals like the leveraged buyout of Harrah's Entertainment (and the billions of dollars in debt taken on by competitor gaming companies such as MGM Resorts International and Las Vegas Sands) made sense to everyone involved: the bankers who were underwriting it, the hedge funds who were buying it, and the casino owners who would be servicing it from the easy money they were sure to keep raking in. Loveman and his Apollo and TPG partners had run the numbers, gone through the probabilities, and concluded that servicing their $24 billion debt load was only a matter of maintaining single-digit gaming growth. Thanks primarily to Loveman's loyalty program, Harrah's had achieved annual double-digit growth for the previous half-decade. The plan of the private equity investors was to take the company public after a few years and rake in billions in management fees, dividends, carry charges, and initial public offering profits.

That fight weekend was among the best in Las Vegas history. Casino drops were fantastic, according to Harrah's, and occupancy throughout the town was 99 percent. Total Las Vegas gaming revenue would peak in 2007 at $10.9 billion, before falling to $9.8 billion in 2008 and $8.8 billion last year, according to the Las Vegas Convention & Visitors Authority. Harrah's worldwide revenue fell, too, from $10.8 billion in 2007 to $8.9 billion last year.

On the June weekend three years later when I flew in to meet Gary Loveman, the half-dozen building projects that had started in the midst of the boom, financed in part by all that debt, were stalled and mothballed. With the Las Vegas Strip's gaming revenue down from $6.8 billion in 2007 to $5.5 billion by 2009, the demand for more slot boxes just wasn't there, nor was the revenue to service the debt. Huge projects like MGM Resorts' CityCenter required a $270 million infusion of crisis funding. Boyd Gaming had halted construction of its $4 billion Echelon Place, the $3 billion Fountainebleau had filed for bankruptcy. Although Harrah's had not taken part in the slot box boom, it had expanded, then taken on vast debt for a leveraged buyout at precisely the wrong time. "One wouldn't choose to do this in advance of a consumer spending collapse," Loveman concedes. He was forced to find $600 million in cost savings to survive 2009 and had to reinvent himself as a financial engineer. "Summer of '08 was an inflection point," says Harrah's Chief Financial Officer Jonathan Halkyard. "We went from thinking of growing to thinking of surviving."

Loveman, meanwhile, had gone from running a public company and answering to a board and shareholders to running a private company, along with his private equity partners, and answering to his debt-holders. "The balance sheet had become our adversary," he says. "You look at the situation in October 2008 and revenue is falling away in an unprecedented way. We had created value by taking care of the customer and providing a good experience, but as of the second week of October 2008, that wasn't going to be enough."

By early 2009 investors were anxious about holding more than $14 billion worth of notes that were trading as low as 13¢ on the dollar. Harrah's had just reported its fourth straight quarter of losses; the middle-class gamblers that Loveman had cultivated were staying away from the casinos. Loveman describes what happened next as "learning a new game." He had been brought in to solve a marketing problem, yet suddenly he had to address a balance sheet problem. Renegotiating a crippling debt load in the face of the biggest financial crisis of his lifetime was not something he'd taught at Harvard. "I had to get good at this fast," he recalls.

Halkyard recalls watching Loveman turn the crisis into an opportunity. "Gary is not just conceptually very

smart. He is willing to get into details. He digs in." Loveman concluded Harrah's had to reduce debt and debt servicing expenditures, so the company executed 13 capital markets transactions, Halkyard says, reducing debt by about $4.5 billion and pushing out the maturities to buy time. (Harrah's ended 2008 with $24 billion in debt; today it owes about $19 billion.)

What Loveman was doing, with a huge assist from Marc Rowan, managing partner of Apollo, and David Bonderman, a founding partner of TPG ("the F-16 pilots of debt refinancing," as Loveman calls them), was making holders of Harrah's debt an offer they couldn't refuse: Trade your old debt for new debt, and take a haircut in the process. The alternative? Loveman didn't need to spell it out: Watch your investment shrink to nothing as Harrah's is crushed by its own debt. You could pay a little now—a few billion—or pay a lot more later. "It was poker," Loveman says. "It was game theory, something I'm very comfortable with. It was a matter of recognizing and anticipating the decision of the other actor when confronted with the information that would become available to them. Here is the choice set that is available to you, so what are you going to do?"

Loveman knew the answer before he asked it. It was just a matter of figuring out the probabilities.



Women gamble more regularly than men, and older women outgamble everyone. Harrah's marketers act accordingly

Theory Into Practice

Growing up in Indianapolis, Loveman was among the first white kids in town to be bused to a predominantly African American high school. He was a good student, having inherited an aptitude for mathematics from his father, an engineer for Western Electric. The youngest of three siblings, he became an unlikely combination of math geek and popular jock, the only white player on the basketball team at Thomas Carr Howe High School. "I have always been able to get along with a wide range of people successfully," he says. "I think it has something to do with why I was able to go from academia to business and not be repellent to everyone."

Loveman attended Wesleyen University, earned a PhD. in economics at the Massachusetts Institute of Technology, and put in two years as an economic researcher at the Federal Reserve Bank of Boston before joining Harvard Business School. While at Harvard he became interested in customer service, a subject most quants shied away from. "My studies up until that point had been in disciplinary economics," Loveman says. "There was very little formalization of service as a discipline. There is a long history of research and engineering around factory optimization, scheduling, throughput. On the other hand, the service sector was seen as a poor cousin."

When he talked about customer service in his classes, he noticed, his students perked up. We all live as customers, he realized, not plant managers or finance directors. He applied his quantitative background to the subject and proved a link between happier customers and more profitable companies, a connection described in his 1994 *Harvard Business Review* paper "Putting the Service-Profit Chain to Work."

Soon after its publication, Loveman was in demand as a speaker, consultant, and seminar leader for major corporations eager to cash in on his idea that labor was more than a function of cost and that happy employees led to repeat customers who spent more. He says that executives from virtually every industry were interested in hearing his ideas, save one. Asked to lead some Harvard-style case studies with groups of Harrah's hotel and gaming executives, he saw that "the gaming guys wouldn't show up, or if they did, it was clear they hadn't done the reading. They just didn't evidence any curiosity about this subject. They just weren't intellectually curious about anything."

Loveman had been in a casino only once in his life, a quick walk through one in Monte Carlo when he was 26. He played a few hands of blackjack, observed that the odds were against him, and lost interest.

Now, as he considered where his ideas about customer service might best be applied, he realized that casino gambling was precisely the kind of commoditized business—what's the point of differentiation between this slot machine or that craps table?—where customer service could make a difference. In 1997 he wrote a letter to Philip G. Satre, the CEO of Harrah's, outlining some of his ideas.

In 1998, as Harrah's was about to embark on wave of expansion, Satre asked Loveman to take a break from Harvard to become chief operating officer of Harrah's Entertainment. "In terms of income, it was actually a pay cut," Loveman says, since he had to forego the consulting that supplemented his income as a professor. His first big move as COO was to launch a loyalty program called Total Rewards, which became such a success—growing to over 40 million members by 2010, the largest database of probabilities in the industry—that by the time Satre stepped down in 2003, Loveman had become the logical choice to succeed him. "Obviously," says Loveman, "as CEO, I've more than made up for whatever income shortfall I initially experienced." The value of his salary, stock options, and deferred compensation at the time of the Harrah's leveraged buyout was $90 million, according to SEC filings.

PHOTOGRAPH BY MICHAEL EDWARDS FOR BLOOMBERG BUSINESSWEEK

Know Your Customer

Today, the Total Rewards program remains the linchpin of Harrah's success. The first loyalty program in the industry to be applied across every casino in a company, it allowed for a more accurate analysis of betting patterns—probabilities—and a more equitable distribution of "comps" or free rooms, meals, show tickets, and the like. (In the past, such perquisites tended to go to the flashiest high rollers and the noisiest comp-seekers, not necessarily those contributing the most to Harrah's bottom line.) Loveman instituted a similar program for Harrah's staff, who are given points, based on customer satisfaction surveys, that can be redeemed through a website for products. Even Harrah's C-suite executives have their compensation pegged to customer service scores.

To analyze the customer data it collects, Harrah's spends about $100 million a year on information technology, compiling preferences and probabilities that led Loveman to a startling conclusion. Harrah's makes more money from elderly slot machine players than any other demographic in the casino—even the high-rolling millionaires casinos traditionally spent fortunes luring and flying in by private jet. "The slot player was the forgotten customer," Loveman says, "and the slot player offered us the biggest benefit in terms of collection data. ... I had to be willing to be unsexy in this. I can take you to a casino that would have a lot of young beautiful people in there and you would say, 'Man, this is a happening place.' I could take you to another place where there are a lot of people who look like your parents. The latter would be a lot more profitable than the former. My job is to make the latter."

Although Loveman has remade Harrah's as an old-fashioned service sector juggernaut, the firm does have a newfangled engine room. The motor is the database, maintained in Las Vegas servers and managed out of One Harrah's Court, the old corporate headquarters where the IT and marketing departments now reside. Spend a few days at a Harrah's property, and the information the company compiles about you will end up here, analyzed by proprietary software that assigns each and every Harrah's guest a theoretical value. The higher the value given to you—not to be misconstrued as a source of pride—the more likely you are to lose your money to Loveman.

During a recent visit to Harrah's, I sat with two members of the Total Rewards staff, Matthew Bowers and Andrea Mathews, as they pulled up the profiles of various players. Thirty-year-old "A" from Chicago, for example, is a female slot player who has made 36 trips to Harrah's Chicagoland casino in Illinois, playing an average of 47 minutes per trip and losing about $156 each time she plays. She is an active buffet customer, and Harrah's will entice her back soon with bigger and better buffet offers. Next, Bowers and Mathews pulled up my profile. I had spent exactly 8 hours and 34 minutes gambling. They had on my screen the games I played, the duration, and the value I represented. They knew, for example, that I had sat down to play Pai Gow Poker at 12:39 p.m. and gotten up from the table one hour and six minutes later. I had bought in for $800 and cashed out for $1,300. (That was among my better gambling sessions that trip.) They had tracked what I'd eaten, how much I'd spent, and where I'd shopped. Based on my age, gender, zip code, and gaming preferences, they had assigned me a theoretical value of $529, meaning that was how much they expected me to lose every time I came to a Harrah's property.

"You're a good player," said Bowers. "You'll be getting an attractive offer from us." Then he smiled at me. "Please, keep playing."

Which meant I was exactly the kind of sucker they were looking for.

An Asian Recovery?

Harrah's is likely to be around for many years, separating probablities from their money. Thanks to the debt restructuring Loveman engineered in 2009, less than 1 percent of Harrah's debt comes due in the next two years. By contrast, competitor MGM Resorts has 15 percent of its debt scheduled for repayment in that time, according to the company. On Aug. 4, Harrah's reported a $274 million quarterly loss; Loveman said he was "encouraged by the recovery" in Vegas. Returning to double-digit growth, however, requires Loveman to undo his big mistake—not acquiring a gaming concession in Macau. Of the three areas of potential gaming industry growth, Loveman has positioned Harrah's to succeed in two. If Internet poker is ever legalized, then his World Series of Poker is likely to be a dominant brand. And as casinos open up in more states across the U.S.—Ohio last year became the 25th state to legalize casino gambling, according to the National Conference of State Legislatures, and Massachusetts appears deadlocked over the details of a legalization bill—Harrah's, with $3 billion in cash and available credit, is poised to expand into these emerging markets. The third area—booming Asia, where Loveman missed a big chance—remains a challenge. "Gary did an incredible job getting the company through the liquidity crisis." says Frank J. Fahrenkopf Jr., president and CEO of the AGA. "Now he needs to figure out Asia."

Loveman's 2007 purchase of the 175-acre Orient Golf (Macau) Club, which Loveman has described as a "$600 million round of golf," was an attempt to make up for not bidding on a gaming concession a year earlier. Without a license—the Chinese government has allowed six and shows no inclination to increase the number—the land is valuable, but not as precious as it would be with a big, fat Caesars Palace sitting on it. Loveman, who is also chairman of the Harrah's board, and his private equity partners have been working steadily to change that, either by purchasing a share of a concession or lobbying the Chinese government. It was in part to fund whatever Asian expansion becomes possible that Harrah's, in June, swapped $710 million in debt held by John Paulson, who also owns stakes in MGM Resorts and Boyd Gaming, for 9.9 percent of the company, which puts Harrah's current value at $7.2 billion. As part of the deal, Paulson, Apollo, and TPG bought from Harrah's an additional $557 million in bonds.

Paulson will be allowed to register and sell his shares, though Harrah's and its private equity partners say they still control the timing of an IPO. (Paulson does not have a board seat.) Eventually, Harrah's will go public again, providing capital for its Asian expansion. "There are two scarce resources in Macau," Loveman says, "land and gaming licenses. If you wish to have a resort in Macau, you need to have access to those two things. We have one of them."

If Harrah's establishes itself in Asia, Loveman will have completed a remarkable career journey. First, he was a business school professor who saw his theories succeed in practice. Then, a crisis manager who learned a new skill set. And finally, an executive who bounced back from a serious error in strategy and found a way into his industry's most important market. Or not: That chapter hasn't been written, and a post-IPO Harrah's may or may not have Gary Loveman at the head of the company. Someone who analyzes the probabilities as carefully as Loveman has no doubt studied those odds.

He says he is prepared for any eventuality. When he left Harvard back in 1998, he recalls, he thought of it as a sabbatical anyway. B

Bloomberg Businessweek **MARKETPLACE**

For Ad Rates and Information Phone: (312)464-0500 • Email: MMiller@classifiedinc.com

Franchise Opportunities



Business Services



Watches



Headsets



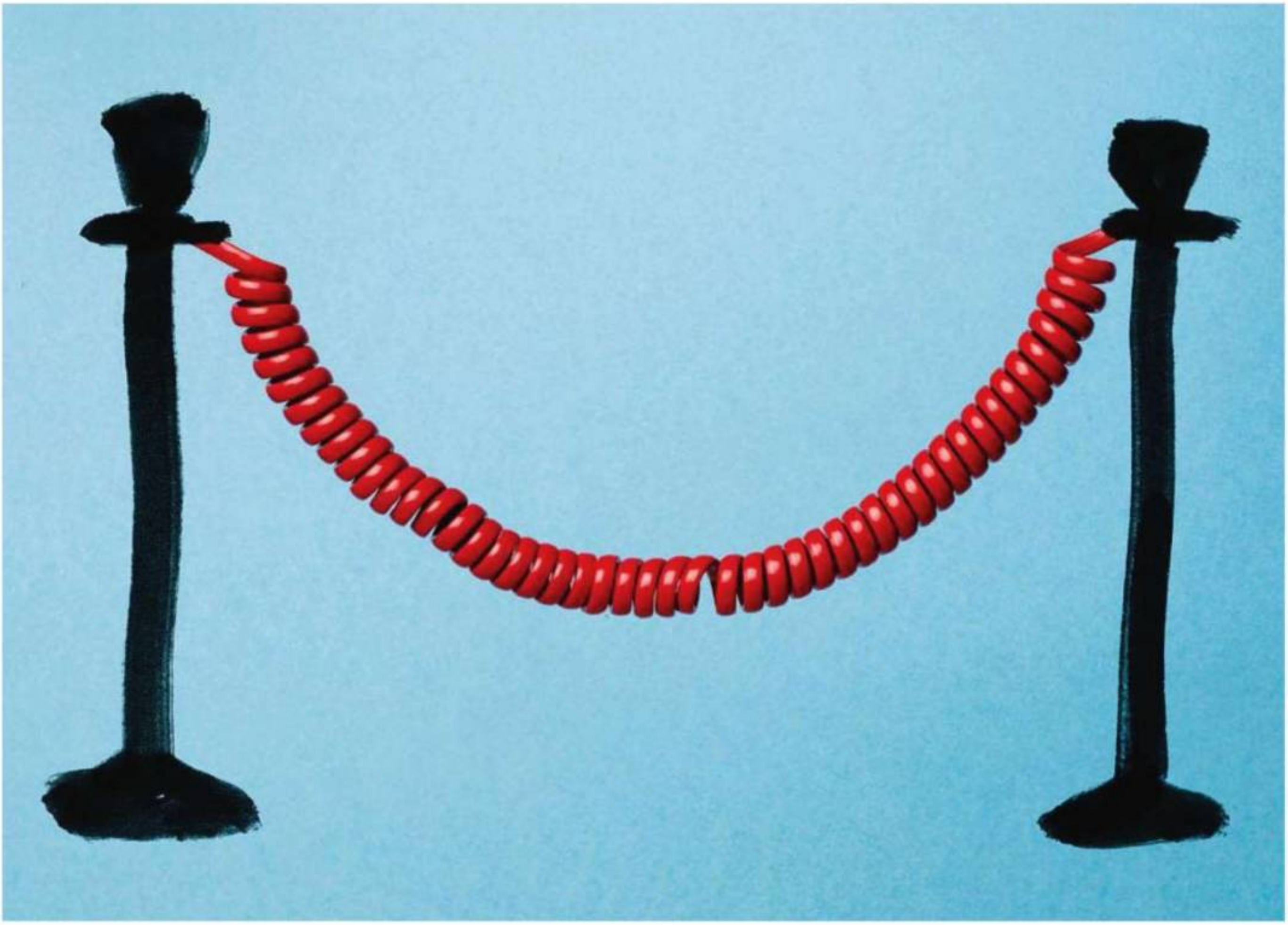
The best summer low-season vacations. Page 82

Folgers & Value Vacations & Digital Pens

Etc.

Wear a statement necklace like you mean it Page 81





America's Most Exclusive Club

In the ultimate power move, there are people who don't own a cell phone. And they're making the world work for them. *By Joel Stein*

Illustration by Tamara Shopsin & Jason Fulford

TOP: JAMIE MCCARTHY/WIREIMAGE

Etc. The Cell-Free Club

Your boss not knowing how to type, John Madden refusing to get on planes—these are adorable quirks caused by being old, or phobic, or old and phobic. But a cell phone is so simple to use, so harmless, and so integral to how we've agreed to communicate as a society, that refusing to own one isn't just the act of a Luddite. It's a pretty serious power move.

Everyone has a cell phone now. There are more than 280 million mobile subscribers in America, according to the Federal Communications Commission. According to a 2005 international study by *Advertising Age*, 15 percent of Americans have interrupted sex to answer their phones. Even people who are videotaping themselves having sex, like Paris Hilton, stop to answer a call.

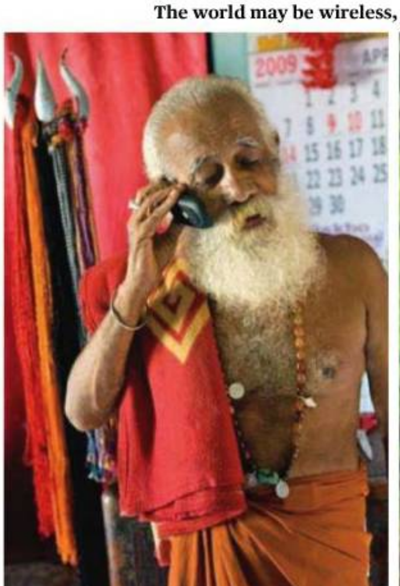
Not having a cell phone is a way of getting the world to run on your time. A lot of powerful people are already on to this. Warren Buffett doesn't use one. Nor does Mikhail Prokhorov, the 45-year-old Russian billionaire who owns the New Jersey Nets. Tavis Smiley doesn't own one, either.

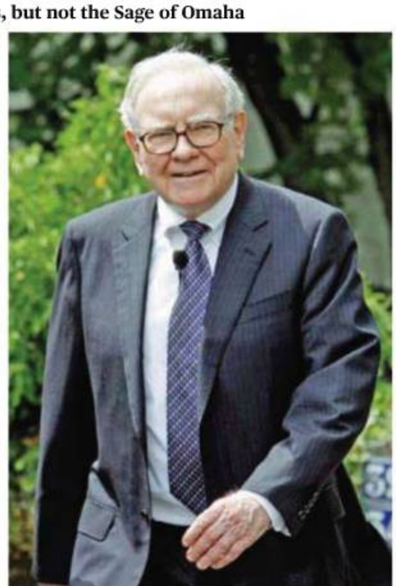
Smiley, 45, the host of a weekly PBS talk show and a national radio show, freaked out two years ago after realizing he couldn't remember phone numbers or appointments without checking his cell. Smiley believes his decision to give up his cell phone has benefited his 75-employee company, The Smiley Group. "At first everybody was complaining that it would be the death of the company," he says. "What's actually happened is that they get more conversation with me than they used to."

Smiley did suffer cell-phone withdrawal symptoms. "The first weekend I was on the road without a phone, I think my hotel phone charges were $1,000," he says. When he travels now, he steals his assistant's phone.

What do Warren Buffett and and Tavis Smiley have in common? Absolutely nothing, except they don't use cell phones

The world may be wireless, but not the Sage of Omaha





Getting off the mobile grid forces others to wait for you to get in touch with them. Afsheen John Radsan, 47, a professor at William Mitchell College of Law in St. Paul, Minn., was assistant general counsel at the CIA and an attorney at the Justice Dept. All *sans* cell. He even refused to get an answering machine until his parents installed one at his apartment behind his back. Radsan began his habit of not answering phones when he was a young lawyer at Sullivan & Cromwell. "If you were called on a Friday, it could only be a partner asking you to work over the weekend," he remembers. "And we had caller ID. So some of the partners would call from an outside phone and say, 'We got you!'"

Working at the CIA, oddly, reinforced his decision, since he couldn't bring any gadgets into the building or take home any of his work. After getting to know the son of an ayatollah, who explained the importance of not responding to everything, Radsan, an avid reader, knew he made the right choice. "I love Russian novels, and [with cell phones] I'm not sure our day-to-day life is any better," he says. His ban on laptops in his classroom has caught on with other professors, he says. The only person his habit seems to annoy is his wife. "She wants to do things on the fly. I'm of the mindset that we can avoid that just by planning. I say, 'Katy, I'll be home at 7 or 7:30,' and she says, 'Let's talk about it later.'"

Hanya Yanagihara, 35, traveled the world as a deputy editor for *Condé Nast Traveler* without any portable communication device. "In India, even the yak herders and rickshaw drivers have cell phones," she says. Occasionally, when her plans get canceled, she wishes she had one. A few weeks ago her plane schedule got scrambled and she had to tell an associate, so she borrowed a phone from a stranger on her flight. "They give you a sort of pitying look, and assume you're lying or hitting on them," she says of cell-phone lenders. "Then they ask for the number and carefully punch it in. They think you're calling international. They're very suspicious."

Jonathan Reed, 46, dean of the College of Arts and Sciences at the University of La Verne, east of Los Angeles, loves traveling without a cell. "I'll talk to strangers. I love going to Italy, where everyone talks to everyone all the time," he says. "A cell phone signals that my whole world is me and it excludes everyone else." He says he has never overheard a cell conversation that wasn't banal. "When I walk around campus, if students are talking to each other in person, you can hear some very interesting conversations." Recently, while in Israel for archeological work, he was struck by how much people use their mobile phones—usually two or three—as status symbols. "I was sitting at a very nice restaurant and two men were sitting there with beautiful women and they were on their phones. Do they have someone better on the other line?"

Reed, like many of his tiny tribe, cites increased efficiency as a reason for not having a cell. "I'm more

ABBAS/MAGNUM PHOTOS; LAURENT GILLIERON/EPA/CORBIS

The Call Of The Wild

With more than 280 million mobile subscribers in America, our addiction to cell phones is influencing our behavior. Consumer electronics reviewer Retrevo's Gadgetology Report, which regularly surveys thousands of Americans of all ages on their feelings about technology, shows cell phones are even affecting our most prurient moments.



7%

People who would willingly suspend sex to check an electronic message or take a call on their cell

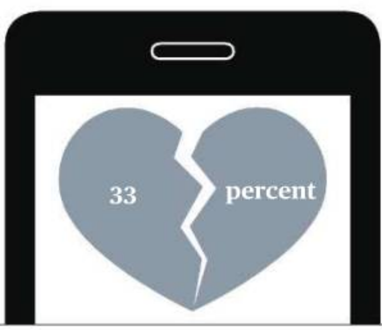
NSFW

20 percent

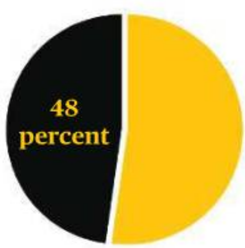
iPhone owners who admit to watching adult material on their phones; 10 percent of BlackBerry users admit the same

28 percent of people think children should receive their first cell phone between these ages





iPhone owners who have dumped someone by text or e-mail—the modern Post-it note of relationship insensitivity



People who check their Facebook or Twitter account during the night or as soon as they wake up

33 percent

iPhone owners who find out-of-date gadgets a "turnoff"

focused. It forces me to be proactive," he says. It's also a useful management tool. "With 80 to 100 faculty, I wouldn't want to be shackled by a cell phone. In what I do, it's important to pay attention to people when they get a meeting with you. I see people reaching in their pocket when [their phone] vibrates–all of that distracts from your work. At meetings, colleagues of mine miss opportunities to shape the dialogue because they're glancing at their e-mail or going out of the room to make a call."

These non-cell-phone users don't avoid all modern forms of communication. Many are on Facebook and Twitter, and almost all are besotted by e-mail, which gives them time to insidiously shift the conversation to a moment convenient for them. Elena Kostoglodova, a senior instructor in Russian at the University of Colorado at Boulder, whose voice mail says not to leave a message since "my official means of communication is e-mail," responded to my three questions about not using a cell phone with an e-mail twice as long as this article. To summarize: She resents a phone's drain on her time. "I do not want to take calls when I'm playing with my daughter, thereby sending her the message that she is less important than the people who call;" "I don't want to expose my private or professional life talking on a cell phone in public." If students are caught using a cell phone in her class, she promises to reduce their grade by 2 percent. The only time that she was sorry not to have a mobile phone was when a teenager rammed into her car. She had to ask the kid to call the cops.

> **"You can live a 1992 lifestyle and live pretty well," says one adamant cell non-user**

There are some Luddites among the cell-less class. Not only does Kurt Labberton, a 59-year-old dentist with a staff of six in Yakima, Wash., not have a cell phone, he also avoids e-mail. Instead, he sends his patients handwritten notes. "A quick e-mail is not the same as something with a postage stamp on it," he says. "The one thing you can offer in dentistry is the intimacy of the moment." Labberton sees the impact of cell phones firsthand: He has interrupted root canals and abscesses so his patients can answer calls. Still, he claims, "you can live a 1992 lifestyle and live pretty well." Especially if you have an office full of people communicating with 2010 for you. B

HILTON: JOHNNY NUNEZ/WIREIMAGE

Folgers sold $732 million worth of ground coffee through general U.S. retail channels last year. Maxwell House sold $424 million.



The Comeback Lids

Folgers and Maxwell House still want to be popular—it's just not working. *By Benjamin Wallace*

In a post-Starbucks world, when 40 percent of the coffee consumed in the U.S. is classified as gourmet by the National Coffee Assn. (NCA), it's easy to forget about supermarket stalwarts Folgers and Maxwell House.

However, the two still dominate the home brewing market. Folgers, owned by J.M. Smucker, is the clear leader, according to market research firm SymphonyIRI Group. In regular and decaf grounds, Folgers sold $732 million worth of coffee at supermarkets, drugstores, and mass retailers, excluding Wal-Mart Stores, for the year ended July 11. Maxwell House, owned by Kraft Foods, sold $424 million. Starbucks, by comparison, sold only $245 million.

The good news for Folgers and Maxwell ends there. Growth is soft to nonexistent—and the product seems dated. In 2007, its most recent survey of the brands, website Coffee Review noted the category "continue[s] to betray us with coffees that actually seem to achieve the impossible—[they] get worse every time."

While left-for-dead brands like Pabst Blue Ribbon have enjoyed comebacks by promoting regular-guy unpretentiousness, Folgers and Maxwell House recently tried to rehabilitate themselves by tinkering. Maxwell switched its flagship blend to 100 percent arabica beans (from lower-quality robusta) and this year launched a series of "foaming latté" drinks—instant coffee flavors with a layer of foam on top. It also followed the trend of coining fancy-sounding flavors, like its South Pacific Blend. Folgers has Caramel Drizzle and Vanilla Biscotti, and recently added a step in its roasting process. This fall it will unveil a Keurig pod—a powerful symbol of the new coffee regime.

Such changes are unlikely to do more than hold on to wavering loyalists. In a recent sampling of both brands,neither had much flavor. Compared with other choices, Folgers was particularly acidic, Maxwell less so. "The consumer's just so much more aware of the variety out there," says equities analyst Matt Arnold of Edward Jones. "For not much more money, the experience is pretty different in terms of the coffee you can have." During the downturn, the number of those making coffee at home rose from 82 percent to 86 percent, according to the NCA. As the world emerges from recession, expect that number to fall—and Folgers and Maxwell to feel the heat. "If you're ranking opportunity through a growth lens," says Arnold, "this is one of the last places you're going to look." Ⓑ

Will Maxwell House and Folgers' historic appeal endure? Some are doubtful: "The consumer's just so much more aware of the variety out there," says Edward Jones analyst Matt Arnold



TOP: ILLUSTRATION BY DAMIEN CORRELL

Etc. One True Thing



When costume jewelry first hit the market in the 1930s, it was meant to be worn with a specific outfit, then thrown away.

This piece's $150 price tag is made possible by the hand-set Czech glass stones and acrylic beads used in place of diamonds and pearls.

MISSION: STATEMENT

How to wear a bold necklace to the office

Rule 1

Wear a solid-colored top. Prints and stripes are distracting.

Rule 2

Don't pair with anything low-cut; you're better off wearing a classic scoop-neck shirt.

Rule 3

Wear only the bare necessities in rings, bracelets, and earrings.

Rule 4

Pair with a casual outfit. Big necklaces look great with basic tees but can make dressier garments look too splashy for work.

Michelle Obama is an expert at pairing statement necklaces with outfits



The Statement Necklace

A big bauble to add glamour to the everyday office look

The Want: A bold necklace is the quickest way to upgrade an outfit. The piece must be stylish, not too gaudy, and versatile enough for both business lunches and after-work drinks.

The Get: J. Crew's Pearl cluster bib necklace ($150 at jcrew.com). A reinvention of the classic pearl strand, the chain-mail bib meshes muted tones and subtle sparkle. This necklace adds a hefty dose of shine to an otherwise simple outfit. It looks equally polished when you're in the office, wooing clients, or out on the town—no matter what the season. B

—*Doria Santlofer*

TOP: PHOTOGRAPH BY JAMIE CHUNG FOR BLOOMBERG BUSINESSWEEK; BOTTOM: BROOKS KRAFT/CORBIS

Etc. Navigator

Low-Season Travel

Get the most out of your summer vacation by hitting these hot spots when their business is cool



More than 400 miles of mountain biking trails cut through the Wasatch Range

Mountain Biking Adventure
Park City, Utah

Ski-centric Park City's low-season prices go into effect during the best time of year for exploring the Wasatch mountain range. **Deer Valley Resort** (above) has a world-class, lift-accessed mountain bike trail system for all levels. Zip through Aspen groves on your own or hire an instructor (full-day bike rental and lift ticket: $104). Bring friends and enjoy Park City from a two-bedroom loft with mountain views, deck, and hot tub at **The Sky Lodge.** It's near the town's best boutiques and restaurants–including Robert Redford's brasserie, **Zoom**. During ski season these lofts go for $1,400 a night and up. August and September rates drop to $450 per night.

The Family Trip
Orlando



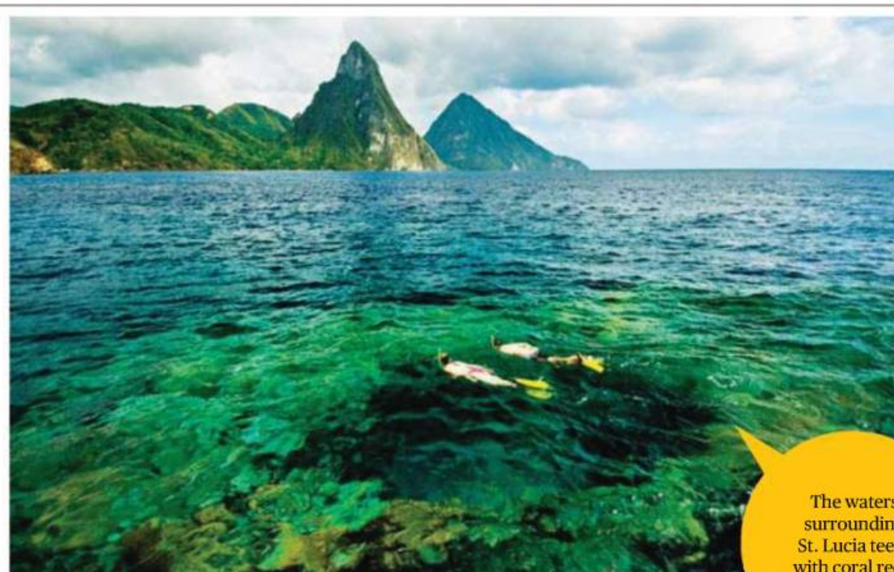
Disney World's low-season discounts begin on Aug. 15, corresponding with the start of school in Southern states. This creates a three-week window for parents from the rest of the country to seize on the lowest rates of the year before school is in session. Book a six-day Magic Your Way package for before Oct. 7 and Disney will throw in a free meal plan–a savings of $689 for a family of four. Besides free chow, it includes a garden view room at the **Grand Floridian Resort & Spa** (below). Families of four will pay $3,225 for the week. The same package–without a dining plan–shoots up to $4,327 over Christmas break.



Going off the Grid
Soufriere, St. Lucia

Known for white-sand beaches and the Pitons–ancient volcanic plugs rising 2,500 feet out of the water–St. Lucia is a good Caribbean bet for avoiding hurricane season and capitalizing on discounts. There are direct flights from New York, Philadelphia, Charlotte, N.C., and Miami; one-way flights from New York dip as low as $140 on American Airlines and $160 on JetBlue. For a great view of the Pitons, book **Anse Chastanet Resort** in Soufriere. It throws in a fourth night free if you book by Aug. 15 and travel by Oct. 1. Four nights in a standard room in mid-August runs $1,834. In January, it's $1,000 more.





The waters surrounding St. Lucia teem with coral reefs and sea life

A beach bungalow at Chaaya Island Dhonveli runs $272 per night in August

Surfing Oasis
The Maldives

Venturing to these coral islands in the Indian Ocean is never cheap, but August and September see the year's most affordable rates overlap with the end of surf season. Base your trip in the **Chaaya Island Dhonveli** (right), a 148-room resort where you can see the waves pumping off Pasta Point (this island used to be a popular Italian retreat) from your digs. A beach bungalow runs $272 per night in August and $222 in September. Emirates is your best bet for a last-minute flight in August, ringing up just over $2,000 round-trip. If you book now for September travel, Qatar Airways flights from New York, via Doha, drop to $1,393 round-trip.





Making Like a Medici
Florence

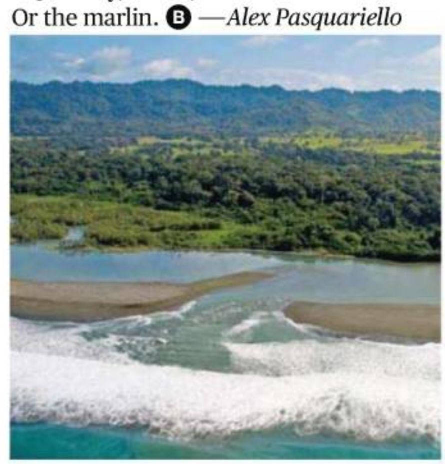


Like much of Europe, Florence goes on holiday in August. While many trendy boutiques and restaurants close until the fall, the city's Renaissance glories remain open, the lines shorten, and hotel deals abound. The elegant 13-room **Casa Howard Guest House** gives you a great base to visit the **Uffizi Gallery** (above) and **Cappelle Medicee**. (It charges in dollars via a quirky formula, taking its lowest low-season euro rate, adding 10 percent, and using that number for the dollar rate.) Double occupancy in the garden room for five nights goes for €130 per night (about $170) through August. Pay in dollars and it's $143 (130 plus 13). Or skip the calculations and book three nights in the garden room for $390, saving you about 13 percent off low-season rates and almost 63 percent off the September rates.

The Deep Sea Fishing Expedition
Drake Bay, Costa Rica

Summer rainy season in Costa Rica coincides with blue marlin and yellowfin tuna season off its Pacific coast. Forty-plus International Game Fish Assn. records have been caught within 80 nautical miles of **Aguila De Osa Inn**, which is accessed only by floatplane or boat. At the hotel, charter a souped-up 31-foot boat with crew for the day ($900). Go in August or September and get a fifth night free, plus a package that includes meals and diving. Five nights in a junior suite for two and airport transfers goes for $1,834. In January, it's $3,020—without activities. Or the marlin. Ⓑ —*Alex Pasquariello*





SNORKELING GEAR: IMAGE SOURCE/GETTY IMAGES; ST. LUCIA: TURNER FORTE PHOTOGRAPHY; UFFIZI: PAUL SEHEULT/EYE UBIQUITOUS/CORBIS; TUNA: TONO BALAGUER/AGE FOTO STOCK; STATUE: VINCENZO PINTO/AFP/GETTY IMAGES; COSTA RICA: ROY TOFT/NATIONALGEOGRAPHIC STOCK



No Country for Old Pens

With Livescribe's smartpen, your handwritten notes and doodles go digital. *By Arik Hesseldahl*

Ever since the first caveman scrawled on a wall with stone, people have been looking for a way to improve the writing process. This eons-long evolution has brought us to the Livescribe Echo—a pen that moves handwriting into the digital domain.

The Echo, which sells for $199 (8 gigabytes) or $169 (4 gigabytes), is the second generation of Livescribe's so-called smartpens. It writes like any other pen. When applied to special paper, however, it digitally captures a precise image of your handwritten notes, sketches, and doodles. It also has a sound recorder for meetings and lectures.

Setup is a breeze. Connect the pen to your computer using a USB cord—accompanying software supports both Windows and Mac OS X—and your uploaded handwritten notes will appear exactly as they did on the page. They'll be arranged in an iTunes-like application called Livescribe Desktop that lets you read, organize, share, and print them. If you were recording sound simultaneously, the page is presented as a "pencast" on your screen with your words highlighted in synchronization with the sound.

Echo has invited third-party developers to create apps. Some of the more than 75 available are useful for composition (a translator), while others are more suited for procrastination (blackjack). I tried the dictionary app, which worked as advertised: Every time I wrote a word, the definition appeared on the pen's tiny display. With the app priced at $15, though, I'd almost rather lug a paperback Webster's.

To save your handwritten pages, the Echo requires paper with a faint pattern of powder-blue dots—a technology developed by Anoto, a Livescribe partner. (The tiny camera below the nib uses those dots as reference points.) Livescribe offers on its site—and at retailers such as Best Buy—special notebooks and Moleskine-style bound journals, usually sold in two- and four-packs for between $8 and $25.

Sure, $199 is a lot for a pen—particularly one without a GPS to keep you from losing it. That said, it's a useful tool for doctors, executives, and academics (as well as college students) who still need to write things down. The pen is also handy for tech reviewers who commute. I wrote this column with one. My handwriting was sloppy, but I was amused my scribbles could be digitally preserved for posterity. B

i

The Livescribe Echo

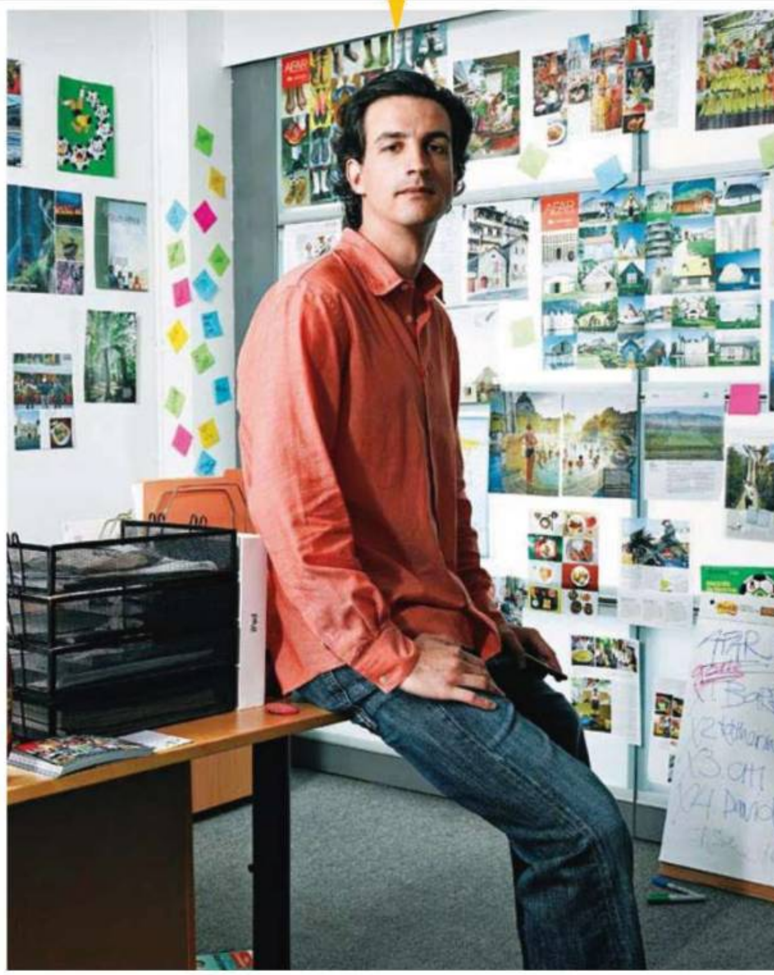
The smartpen contains a camera that digitally captures notes jotted on special paper in Moleskine-style journals (below).



CHISEL: PHOTODREAMS/ALAMY; QUILL: SUNG-IL KIM/CORBIS; FOUNTAIN PEN: COMSTOCK IMAGES/AGEFOTO STOCK; BALL POINT PEN: OPEN DOOR/ALAMY

Going Glossy in The Housing Bust

Diaz knew it was time to leave real estate in 2006, when his mailman and neighbor both asked on the same day: "How about this real estate thing?"



When Joseph Diaz saw the bubble, he sold his real estate company—and launched a travel magazine

A real estate investor and a used-car dealer going into business together sounds like the beginning of a bad joke. Especially when that business is a travel magazine. Yet Phoenix-based friends Joseph Diaz, former head of the Diaz Mendell Group, and Greg Sullivan, past chief executive officer of DriveTime Automotive Group, launched *Afar* magazine amid the media meltdown that shuttered glossies from *CosmoGirl* to *Gourmet*.

The frothy residential real estate market began to worry Diaz in 2006 when both his mailman and next-door neighbor asked him on the same day: "How about this real estate thing?" By the end of the year, Diaz, 30, sold his holdings and began looking for a new opportunity. To clear his head, he set out to India and South America with Sullivan, 52, a friend he'd met on a recent deal. While drinking Kingfishers on a beach in western India, Diaz says he realized "there wasn't a travel magazine capturing a place through a local set of eyes." Sullivan, then recently retired, agreed. So began *Afar* magazine.

After returning from India, Diaz read a dozen how-to books on the publishing business and then flew to New York to meet James B. Kobak, a veteran adviser to magazines such as *Playboy*. Kobak suggested they put together three sample issues. Diaz and Sullivan went a step further. With $15 million of their own money and investments from family members, they started an operation in San Francisco and hired a small staff of editors and salespeople. In August 2009 they launched the glossy, photo-laden *Afar*.

Each bimonthly issue remains an adventure. Its first publisher and editor-in-chief didn't work out, and Sullivan has taken over the editorial direction. Diaz spends half his time on the road marketing the glossy. "If we realized how much work it was," he jokes, "it might have prevented us from doing it." Still, in one year *Afar*'s circulation has increased 50 percent, to 75,000. The magazine hasn't turned a profit yet, but it's preparing to launch afar.com, an online social networking component. "We're pretty optimistic," says Diaz, "considering we launched during the worst time in the industry's history."

—*Alexandra Wolfe*

The July/August 2010 issue of *Afar* magazine (top)



FROM PUSHING PROPERTY TO SELLING AD PAGES

$15 m — Amount required to start up *Afar* magazine, raised by Diaz and Sullivan	**120 to 150** — Days per year that Diaz spends on the road marketing the glossy
$41,964 — Amount the magazine has spent on airfare since its August 2009 launch	**$9,750** — Cost of a single-page ad in *Afar* (there were 20 in the July/August issue)

DATA: *AFAR*

TOP: PHOTOGRAPH BY MARTHA CAMARILLO FOR BLOOMBERG BUSINESSWEEK

According to Nick Bilton, the $20 billion porn industry can teach us about consumer preferences



ILLUSTRATION BY DIEGO PATINO

The Digital Future: You Know It When You See It

The future of media is still about storytelling—just not the kind you think. *By Paul M. Barrett*

The digital revolution has now replaced the financial crisis as publishing's favorite nonfiction subgenre. The shelf groans with books on how the Internet is remaking culture, the economy, neural circuitry, and just about everything else. For good reason: It is. The optimists, like Clay Shirky (*Cognitive Surplus: Creativity and Generosity in a Connected Age*), see online networks as bringing out the best in us. Nicholas Carr (*The Shallows: What the Internet Is Doing to Our Brains*), among other pessimists, warns that the Internet's glimmering promise disguises a solipsistic realm of trivial obsession.

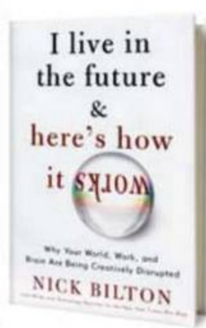
Staking a claim amid this crowded field is Nick Bilton, a technology writer for *The New York Times*. His ideas, expressed in sprightly prose, go to extremes, and, for the most part, lack practical application to mainstream business. Some of them are even downright alarming. Does the online pornography industry suggest a new business model for stodgy old-media companies? Do newspapers, in their desperate search for profits, need to become more like violent video games? In his forthcoming *I Live in the Future & Here's How It Works*, out next month, Bilton says the answer is yes. He tells media businesses to forget about luring traditional readers or viewers. Bait your hooks, instead, for "consumnivores." For better or worse, he writes, immediacy now trumps quality, and all commercially viable content now focuses on "Me."

He's got a point. If a media outfit wants to attract page views and advertising dollars, supplying fresh gossip, financial information, dating opportunities, and status updates are all feasible strategies—and there's nothing inherently wrong with any of them. Another strategy is marketing the quintessential self-pleasing media product: pornography. According to Bilton, the $20 billion porn business has much to teach the rest of us about adapting content to ever-more-specialized consumer preferences. He devotes his opening chapter to some of the XXX website operators he calls "test drivers for new media." Adult magazines and videos are fading fast, but low-budget, highly specialized hard-core sites are thriving, he reports with palpable enthusiasm.

i

I Live in the Future & Here's How It Works: Why Your World, Work, and Brain Are Being Creatively Disrupted

By Nick Bilton
CROWN BUSINESS, 304 pp, $25



Fetishes predated the Internet, of course. Now they're just easier to indulge. Without having surveyed the distant borders of digital smut, I wonder whether Bilton may underestimate the perversity of niche porn. Regardless, he then makes this bizarre leap: "The porn industry shows us that people will pay for good storytelling." What? At this point, one wonders whether Bilton understands the not-very-literary way porn story lines are typically put to use. The dialogue isn't exactly the point.

As his book unfolds, it becomes clear that "storytelling" is central to Bilton's rosy vision of the next generation of the media business. "We're all just storytellers," he writes. "Whether you're writing a book or a news article, selling an outfit or a car, writing a blog post about your weekend or a press release about a new product, you're telling a story. Whether it's 140 characters long, the length of this book, a video, interactive, 3-D, or in-person narrative, it's a story." Unfortunately, he doesn't identify the precise lessons Random House, NBC, or *The New York Times* are supposed to draw from porn, or even from Twitter. How, for example, would a serious news organization retain credibility while at the same time engaging readers' more lascivious pursuits?

Bilton deeply admires video games. They offer "engaging, immersive, truly multimedia storytelling and can draw in participants more powerfully than many traditional storytelling methods." He favors Modern Warfare 2, a military shoot-'em-up adventure. "It refreshes me for other work I have to do," he says. Elaborating on an argument popularized by Steven Johnson in *Everything Bad is Good for You*, Bilton says some games may produce dopamine in the brain, a chemical that plays a role in the experience of pleasure and the exercise of intelligence. Bilton deftly summarizes research showing that video game-like training may help surgeons hone their hand-eye coordination. Pilots have trained with video simulation for decades. The Pentagon is experimenting with games designed to improve new recruits' reflexes and peripheral vision.

From these narrow applications, the author makes another strange leap, arguing that video games, broadly speaking, are good for kids, a gateway for interesting them in books and newspapers. "Long-form content isn't going to die," he writes. "Kids may seem distracted, but they will play video games for an average of three hours a day—which sounds like long-form content to me. If they don't read a whole book in two days or stay with a television show, it isn't because they can't concentrate. It's because we haven't adapted the storytelling to fit their changing interests."

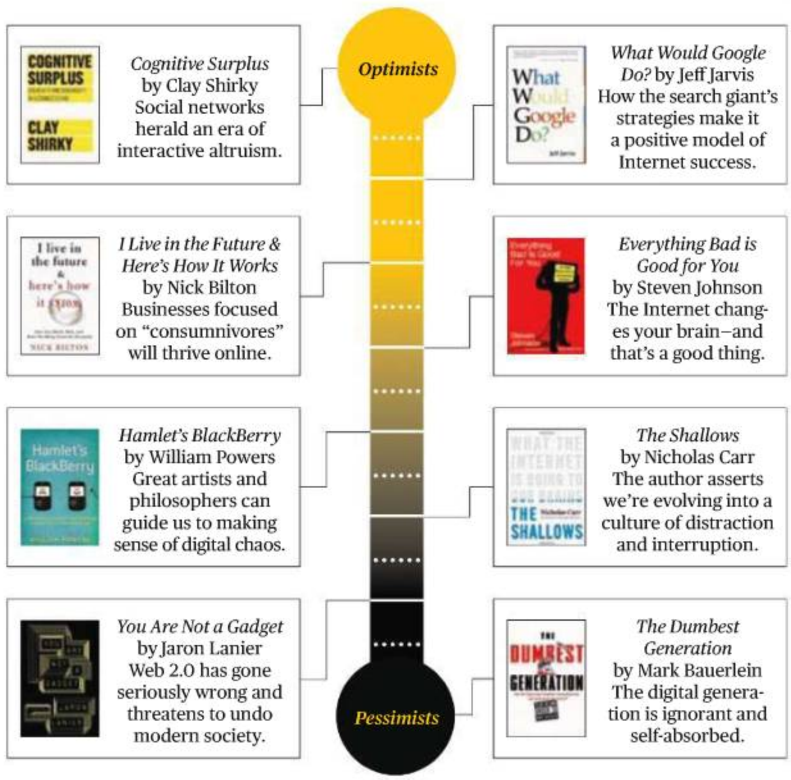
This seems, at best, naïve. Left alone with an Internet connection, most kids will waste time. (As will most adults.) Nothing wrong with having fun, but let's not pretend they're going to somehow absorb history, biology, current events, or any other subject that makes long-form content worthy of the time investment. I'd like to meet a set of parents who, as a matter of common sense, prefer their kid play video games rather than ride a bike, collect bugs in a jar, or read a good book.

As for the video game lessons to be learned by mainstream businesses, Bilton doesn't offer any. "I don't have any great answers or easy solutions to bringing in more revenue in a digital world," he concedes—a major letdown. Given how much has been written about the Internet and the future of media, it's time for the digital boosters to begin thinking more rigorously about—and offering solutions for—two pressing problems: the alluring but harmfully distracting underside of virtual entertainment and the desperate need for ideas about how to make an honest living in an online media world. Ⓑ

What lessons are Random House, *The New York Times*, and NBC to draw from porn—or even Twitter?

Is the Web Making the World Better or Worse? Discuss

Sifting through the growing library of Internet prognostication



Bloomberg Businessweek (USPS 080 900) August 9 – August 15, 2010 (ISSN 0007-7135) S T Issue no. 4191. Published weekly, except for a double issue in August and one in December, by Bloomberg L.P. Periodicals postage paid at New York, N.Y., and at additional mailing offices. Executive, Editorial, Circulation, and Advertising Offices: Bloomberg Businessweek, 731 Lexington Avenue, New York, NY 10022. **Postmaster:** Send address changes to Bloomberg Businessweek, P.O. Box 8418, Red Oak, IA 51591-1418. Canada Post Publication Mail Agreement Number 41989020. Return undeliverable Canadian addresses to DHL Global Mail, 355 Admiral Blvd-Unit4, Mississauga, ON L5T 2N1. Email: bwkcustserv@cdsfulfillment.com. QST#1008327064. Registered for GST as Bloomberg L.P. GST #12829 9898 RT0001. Copyright 2010 Bloomberg L.P. All rights reserved. Title registered in the U.S. Patent Office. Single Copy Sales: Call 800-298-9867 or email: busweek@nrmsinc.com. Subscriber Services: Call 800-635-1200 or log onto our website: http://www.businessweek.com/custserv/manage.htm. Photocopy Permission: Where necessary, permission is granted by copyright owner for those registered with the Copyright Clearance Center (CCC), 222 Rosewood Drive, Danvers, MA 01923 or email the CCC at info@copyright.com. Custom Reprints: For customized bulk reprints of Bloomberg Businessweek articles, contact The YGS Group at 800-360-5549 or email: businessweekreprints@theYGSgroup.com PRINTED IN THE U.S.A.

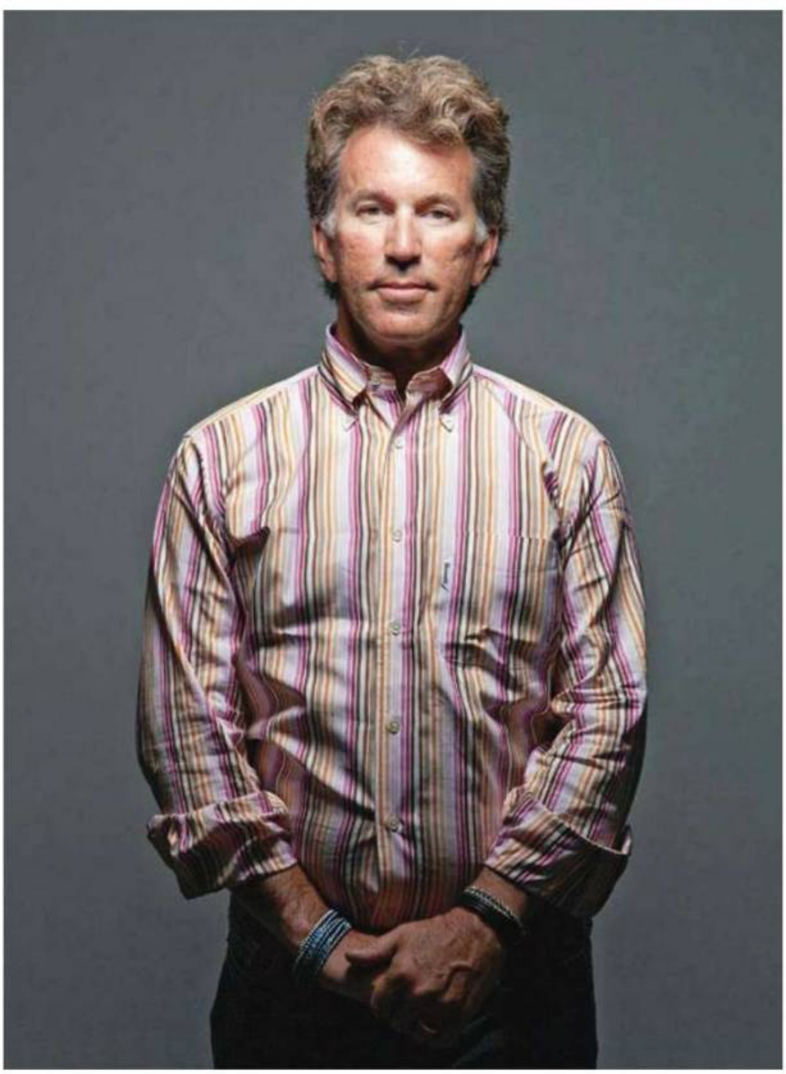
Please Recycle This Magazine
FSC Mixed Sources

Etc. Hard Choices

Jeffrey Hollender

“I knew any deal with Wal-Mart meant a lot of money, but I said no. I didn't want to sell them anything. It felt wrong”

The co-founder and Chief Inspired Protagonist of Seventh Generation on refusing to do business with Wal-Mart–and then changing his mind



When we started Seventh Generation more than 20 years ago, we didn't just want to sell green products. I wanted the business itself to be an engine for positive change.

To me, Wal-Mart was an icon of what's wrong with business. There were labor challenges, questions about their supply chain, and environmental issues. They put smaller companies out of business when they moved into an area. For years, in a very public way, I said we would not sell through Wal-Mart. I couldn't even shop there.

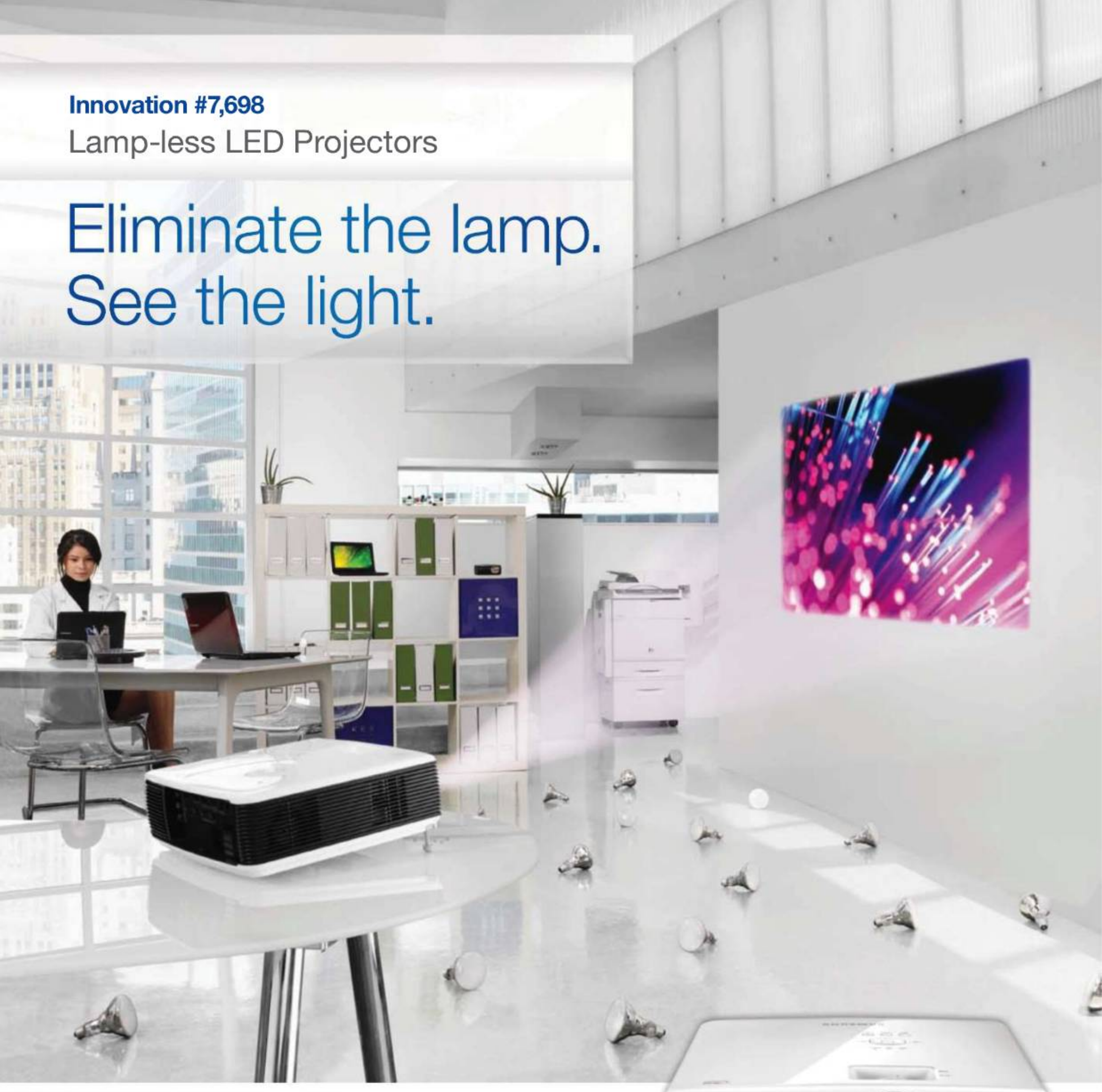
By 2006, I had become more pessimistic that government and NGOs could deal with the problems we faced. I began to think large companies had to lead the charge. I was invited to Bentonville, and met Wal-Mart's head of sustainability. At our first meeting they talked about selling our products. I knew any deal with Wal-Mart meant a lot of money, but I said no. I didn't want to sell them anything. It felt wrong, and many of our customers would have been furious. There was much to be done.

More than a year later, we did a study of retailers and found Wal-Mart's practices put them ahead of some chains we were doing business with. Their reputation hadn't changed but their behavior had. We announced a small test to sell in a few stores and got an angry response from our customers. The negative publicity cost us.

But I started to feel the judgments of some of our consumers weren't accurate. The more people I met at Wal-Mart, the more convinced I was that it was doing an exceptional job of trying to be a good corporate citizen. It no longer felt right to not do business with them.

Now we have struck a deal to sell in 1,500 stores. We're not going into all their stores because I'm not sure we can support that right now. But I feel great about who I'm selling to. They're not perfect. Neither are we. But they're trying to use their strength to do good. *—As told to Diane Brady*

PHOTOGRAPH BY ETHAN HILL FOR BLOOMBERG BUSINESSWEEK





Samsung F10M LED Projector

At Samsung we use our extensive R&D resources to develop innovative products, such as our lamp-less LED projectors that deliver vibrant, intense colors and a lower total cost of ownership. This same innovative approach can be found in our complete line of LED products. Because at Samsung, it's not just business. It's business, innovated.

LED

Discover our future-forward line of LED products at samsung.com/proLED.

SAMSUNG
TURN ON TOMORROW

© 2010 Samsung Electronics America, Inc. All rights reserved. Samsung is a registered trademark of Samsung Electronics Co., Ltd. All products and brand names are trademarks or registered trademarks of their respective companies. Screen images simulated.